

Draft: 11/5/11

FINAL
2011 Fall National Meeting
Washington, DC

JOINT EXECUTIVE (EX) COMMITTEE/PLENARY
Sunday, November 6, 2011
11:00 a.m. – 1:00 p.m.
Gaylord Convention Center—Potomac Ballroom A/B—Level 2

AGENDA

1. Call to Order—*Commissioner Susan E. Voss (IA)*
2. Roll Call—*Commissioner Adam Hamm (ND)*
3. Consider Motion to Adopt the Report of the Nov. 4 Executive (EX) Committee Meeting
—*Commissioner Susan E. Voss (IA)* Attachment One
4. Consider Motion to Adopt the Report of NARAB (EX) Working Group: Recommendation of States
Continuing to Meet Reciprocity Requirements of the Gramm-Leach Bliley Act
—*Commissioner Roger A. Sevigny (NH)* Attachment Two
5. Consider Motion to Adopt by Consent the Committee, Subcommittee and Task Force 2011 Summer
National Meeting Business, Except for Items Noted Below with (*). *Please Note: Minutes were made available
Oct. 20 at www.naic.org and the Synopsis was distributed to members Oct. 20—Commissioner Susan E. Voss (IA)*
6. Consider Motion to Adopt the Report of the Life Insurance and Annuities (A) Committee
—*Commissioner Adam Hamm (ND)* Attachment Three
7. Consider Motion to Adopt the Report of the Health Insurance and Managed Care (B) Committee
—*Commissioner Monica J. Lindeen (MT)* Attachment Four
8. Consider Motion to Adopt the Report of the Property and Casualty Insurance (C) Committee
—*Commissioner Mike Chaney (MS)* Attachment Five
9. *Consider Motion to Adopt the *Background and Implications of Defective Drywall White Paper*
—*Commissioner Mike Chaney (MS)* Attachment Six
10. Consider Motion to Adopt the Report of the Market Regulation and Consumer Affairs (D) Committee
—*Commissioner Sharon P. Clark (KY)* Attachment Seven
11. Consider Motion to Adopt the Report of the Financial Condition (E) Committee
—*Superintendent Joseph Torti III (RI)* Attachment Eight
12. *Consider Motion to Adopt Amendments to the *Risk Based Capital for Insurers Model Act (#312)*
Regarding Life Trend Test and Fraternal Benefit Societies—*Superintendent Joseph Torti III (RI)* Attachment Nine
13. *Consider Motion to Adopt the Statement of Statutory Accounting Principles No. 101
—*Superintendent Joseph Torti III (RI)* Attachment Ten
14. *Consider Motion to Adopt the Model Guideline for Implementation of State Orderly Liquidation
Authority—*Superintendent Joseph Torti III (RI)* Attachment Eleven
15. *Consider Motion to Adopt Amendments to the *Credit for Reinsurance Model Law (#785) and
Regulation (#786)*—*Superintendent Joseph Torti III (RI)* Attachment Twelve

16. Consider Motion to Adopt the Report of the Financial Regulation Standards and Accreditation (F) Committee—*Commissioner Julie Mix McPeak (TN)* Attachment Thirteen
17. Consider Motion to Adopt the Report of the International Insurance Relations (G) Committee—*Commissioner Kevin M. McCarty (FL)* Attachment Fourteen
18. State Implementation Report of NAIC-Adopted Model Laws and Regulations—*Commissioner Susan E. Voss (IA)* Attachment Fifteen
19. Announce Results of 2012 Zone Elections—*Commissioner Susan E. Voss (IA)*
20. Any Other Matters Brought Before the Committee—*Commissioner Susan E. Voss (IA)*
21. Adjournment—*Commissioner Susan E. Voss (IA)*

Report of the Executive (EX) Committee

The Executive (EX) Committee met Nov. 4, 2011. During this meeting, the Committee:

1. Adopted the report of the Nov. 3 joint meeting of the Executive (EX) Committee and Internal Administration (EX1) Subcommittee, which included adopting the reports of the Audit Committee and Information Systems (EX1) Task Force, and the Subcommittee's 2012 Proposed Charges.
2. Adopted its task forces' reports: AIG Managing (EX) Task Force; Government Relations (EX) Leadership Council; International Insurance Relations (EX) Leadership Group; Producer Licensing (EX) Task Force; Professional Health Insurance Advisors (EX) Task Force; Solvency Modernization Initiative (EX) Task Force; Speed to Market (EX) Task Force; and Surplus Lines Implementation (EX) Task Force.
3. Adopted the Report of NARAB (EX) Working Group: Recommendation of States Continuing to Meet Reciprocity Requirements of the Gramm-Leach Bliley Act.
4. Adopted a model law development request for amendments to *NAIC Model Regulation for Recognizing a New Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities* (#821).
5. Received quarterly reports on model law development efforts for the following:
 - Model Law to Regulate Insurance Scoring Vendors
 - Risk-Based Capital for Fraternal Benefit Societies Model Act
 - Amendments to *Model Risk Retention Act* (#705)
 - Amendments to *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786)
 - Amendments to *Standard Nonforfeiture Law for Life Insurance* (#808)
 - *Risk-Based Capital (RBC) for Insurers Model Act* (#312 Fraternal)
 - *Risk-Based Capital (RBC) for Insurers Model Act* (#312 Life Trend Test)
6. Received the report of the NIPR Board of Directors, which included adoption of the NIPR 2012 Budget.
7. Received the report of the SERFF Board.
8. Received the report of the IIPRC, which included election of 2012 Officers and adoption of its 2012 Budget.
9. Announced 2012 NAIC Officer election results as follows: Commissioner Kevin M. McCarty (FL), President; Commissioner James J. Donelon (LA), President-Elect; Commissioner Adam Hamm (ND), Vice-President; and Commissioner Monica J. Lindeen (MT), Secretary-Treasurer.

**REPORT OF THE NARAB WORKING GROUP:
RECOMMENDATION OF STATES CONTINUING TO MEET RECIPROCITY REQUIREMENTS OF THE
GRAMM-LEACH-BLILEY ACT**

In another step toward completion of its charges, the NARAB (EX) Working Group has prepared this report of individual states' continuing compliance with the producer licensing reciprocity requirements of the Gramm-Leach-Bliley Act ("GLBA"), 15 U.S.C. § 6751 *et seq.* GLBA provides that the NAIC shall determine whether the requisite number of states have achieved reciprocity. The NAIC membership originally determined that the states met the non-resident producer licensing reciprocity requirements of GLBA in 2002. In total, 47 jurisdictions have been certified as reciprocal under the 2002 reciprocity standard.

As part of a renewed push toward increased reciprocity and uniformity in licensing processes, the Working Group was assigned the task of reviewing the application of GLBA reciprocity requirements. In 2009, the NAIC membership established reciprocity criteria that represent a more detailed analysis of certain aspects of the original 2002 reciprocity standard as well as a review of issues not included specifically in the 2002 report. This enhanced "NAIC Reciprocity Standard" is more fully discussed in the Working Group's 2009 report to the membership, which is attached to this report as Appendix A and incorporated by reference. The NARAB Working Group is further responsible for determining which states are compliant with this more detailed NAIC Reciprocity Standard and making its report along with recommendations to its parent task force. As in 2002, the Working Group believes that its process for considering reciprocity issues, as detailed below, meets the criteria established for affording deference to the NAIC's reciprocity determination consistent with 15 U.S.C. § 6751(d)(2). Through this report, the Working Group recommends that 40 jurisdictions be certified for reciprocity as of October 3, 2011.¹

Review Process

This report consists of the Working Group's analysis of each jurisdiction's compliance with the revised NAIC Reciprocity Standard. The analysis relies on a detailed review, performed by the NAIC Legal Division, of each jurisdiction's current producer licensing laws, regulations, practices and other state guidance. This review was facilitated by an updated Reciprocity Checklist designed to capture the NAIC Reciprocity Standard, thereby incorporating key elements of the 2002 and 2009 reports.

The steps involved in each state's review can be summarized as follows:

- (1) States submitted Reciprocity Checklists certifying their practices and any supporting laws and regulations.
- (2) Reciprocity Checklists were posted for public comment at http://www.naic.org/committees_ex_pltf_narabwg_reciprocity.htm.
- (3) The NAIC Legal Division independently reviewed relevant state statutes, regulations and other formal guidance, as well as the Reciprocity Checklists, interested party comments, NIPR Business Rules² and documentation arising from on-site reviews of each state's licensing processes.
- (4) Secondary Legal Division review, including follow-up with each state for clarification on potential problem issues and any changes to laws, regulations and practices.

The Working Group's recommendations regarding the reciprocity status of particular states are based solely on the following:

- (1) Review and analysis of relevant statutes, regulations and other formal guidance, including NIPR Business Rules and documentation arising from on-site reviews of each state's licensing processes;
- (2) Certified Reciprocity Checklists submitted to the NAIC by state insurance departments;
- (3) Representations made regarding the application and effect of state law by state insurance department personnel, who have represented they are knowledgeable about the laws and regulations of their respective states, including the practices and procedures, regarding the licensing of non-resident insurance producers;

¹ The NARAB (EX) Working Group approved a report certifying 37 jurisdictions as reciprocal during a conference call on August 15, 2011 and approved a supplemental report certifying three additional jurisdictions during a conference call on October 3, 2011. The Producer Licensing (EX) Task Force approved both reports during a conference call on October 19, 2011 and combined those reports into this single report for consideration by the NAIC Executive Committee and Plenary.

² NIPR Business Rules are written directions governing the electronic processing of applications for initial licensing and license renewal. Each participating state's business rules are developed in consultation with producer licensing personnel and are customized to conform to applicable laws and practices of the jurisdiction.

- (4) Consultations with various state insurance department personnel who are experienced with producer licensing issues, as well as the NAIC Legal Division and other NAIC and NIPR staff who are generally knowledgeable about the licensing of insurance producers;
- (5) Recommendations of the NARAB Working Group through its previous reports regarding a framework for interpreting the reciprocity requirements under GLBA; and
- (6) Comments submitted by interested parties.

Furthermore, in developing its recommendations, the Working Group has made the following assumptions:

- (1) State insurance department personnel have made full disclosure concerning their respective state producer licensing laws and regulations, all applicable licensing practices and procedures, including but not limited to those which may be based on internal rules or procedures, and the decisions, orders, and/or findings of an administrative hearing or court of law, or other action which may be construed as having the effect of law; and
- (2) The laws and regulations reviewed for the purposes, and which form the basis, of the recommendation have not been repealed, revised or otherwise amended subsequent to its review and analysis, and if such amendment has occurred, the states would have provided notice to the NARAB Working Group or the NAIC Legal Division.

By following the described process for each jurisdiction, the Working Group has arrived at a recommendation that 40 jurisdictions presently qualify for re-certification under the NAIC Reciprocity Standard.

Recommended Reciprocal States

Based on its review, as described and qualified above, the NARAB Working Group recommends to the NAIC membership that, as of October 3, 2011, the following 40 jurisdictions be certified as reciprocal for purposes of GLBA producer licensing reciprocity in accordance with the NAIC Reciprocity Standard. Any potential issues arising in the course of reviewing these states are explained in the section that follows.

Alabama	Idaho	Maryland	New Hampshire	South Carolina
Alaska	Illinois	Massachusetts	New Jersey	South Dakota
Arizona	Indiana	Michigan	North Carolina	Utah
Arkansas	Iowa	Minnesota	North Dakota	Vermont
Colorado	Kansas	Mississippi	Ohio	Virginia
Connecticut	Kentucky	Montana	Oklahoma	West Virginia
Delaware	Louisiana	Nebraska	Oregon	Wisconsin
District of Columbia	Maine	Nevada	Rhode Island	Wyoming

Additional states may added to this total based upon resolution of any potential issues that arose in the course of reviewing Reciprocity Checklists or submission of materials for review by the NARAB Working Group.

State-Specific Results

Alabama

Alabama's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Alabama's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes the Alabama meets the NAIC Reciprocity Standard.

Alaska

Alaska's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Alaska's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes the Alaska meets the NAIC Reciprocity Standard.

Arizona

Arizona responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Arizona stated there is a requirement that all producers who sell, solicit or negotiate long-term care insurance must complete long-term care training substantially similar to that offered in Arizona. In its 2009 report, the NARAB Working Group concluded that one-time training and continuing education requirements imposed in satisfaction of a federal mandate are not inconsistent with the NAIC Reciprocity Standard. Arizona’s long-term care training requirement is derived from a federal mandate for state insurance departments to assure state Medicaid agencies that anyone who sells a long-term care partnership policy receives appropriate training. Therefore, Arizona’s requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Arizona’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Arizona meets the NAIC Reciprocity Standard.

Arkansas

Arkansas responded “yes” to Question A2, which asked if there are any requirements or submissions imposed upon a non-resident business entity seeking licensure beyond the four requirements included in the PLMA. Arkansas stated there are statutory requirements to register fictitious names and maintain a registered agent. In subsequent correspondence, Arkansas explained that this requirement is fulfilled through the application and that an additional submission is not required. With this clarification, the NARAB Working Group does not believe Arkansas’s practice is inconsistent with reciprocity.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Arkansas’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Arkansas meets the NAIC Reciprocity Standard.

Colorado

Colorado’s responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Colorado’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Colorado meets the NAIC Reciprocity Standard.

Connecticut

Connecticut’s responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Connecticut’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Connecticut meets the NAIC Reciprocity Standard.

Delaware

Delaware responded “yes” to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from your state. In subsequent correspondence, Delaware indicated this requirement has been removed. As a result, Delaware’s practice in this area is consistent with the NAIC Reciprocity Standard.

Delaware responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Delaware stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Delaware’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Delaware meets the NAIC Reciprocity Standard.

District of Columbia

The District of Columbia's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of the District of Columbia's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes the District of Columbia meets the NAIC Reciprocity Standard.

Idaho

Idaho responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Idaho further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Idaho's response to this question. In subsequent correspondence, Idaho stated it is removing any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Idaho's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Idaho meets the NAIC Reciprocity Standard.

Illinois

Illinois responded "yes" to Questions A1 and A2, which asked if there are any requirements or submissions imposed upon a non-resident individual or business entity applicant or producer seeking licensure beyond the four requirements included in the PLMA. Illinois cited a general producer bond requirement. Illinois subsequently clarified that these requirements are waived as to non-residents. As a result, this practice is consistent with the NAIC Reciprocity Standard.

Illinois responded "yes" to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from your state. In subsequent correspondence, Illinois stated this requirement has been removed. As a result, Illinois's practice in this area is consistent with the NAIC Reciprocity Standard.

Illinois responded "yes" to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident applicants or producers, and "yes" to Question E3, which asked if non-resident surplus lines applicants or producers are required to post a bond. In both cases, Illinois cited bond requirements. In subsequent correspondence, Illinois clarified that these requirements do not apply to non-resident applicants or producers generally or to non-resident surplus lines applicants or producers. As a result, this practice is consistent with the NAIC Reciprocity Standard.

Illinois responded "yes" to question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Illinois further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. In subsequent clarification, Illinois stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Illinois's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Illinois meets the NAIC Reciprocity Standard.

Indiana

Indiana responded "yes" to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state. In subsequent correspondence, Indiana stated this requirement has been removed. As a result, Indiana's practice in this area is consistent with the NAIC Reciprocity Standard.

Indiana responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Indiana further responded that it has a diligent search requirement and that the surplus lines producer is required to perform the diligent search of the admitted

market. Additionally, an interested party submitted a comment letter concerning Indiana's response to this question. In subsequent correspondence, Indiana confirmed it removed the underlying license requirement for non-resident surplus lines applicants and producers. As a result, Indiana's practice in this area is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Indiana's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Indiana meets the NAIC Reciprocity Standard.

Iowa

Iowa's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Iowa's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes the Iowa meets the NAIC Reciprocity Standard.

Kansas

Kansas responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Kansas further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Kansas's response to this question. In subsequent correspondence, Kansas stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. As a result, Kansas's practice in this area is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Kansas's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Kansas meets the NAIC Reciprocity Standard.

Kentucky

Kentucky responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Kentucky further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Kentucky's response to this question. In subsequent correspondence, Kentucky stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Kentucky's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Kentucky meets the NAIC Reciprocity Standard.

Louisiana

Louisiana's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Louisiana's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Louisiana meets the NAIC Reciprocity Standard.

Maine

Maine responded "NA" to Question D, which asked if a non-resident producer's continuing education requirement is met if the non-resident producer fulfills his or her home state continuing education requirement and the home state also grants such reciprocity. Because Maine does not impose continuing education requirements on non-residents that otherwise would be imposed in the absence of reciprocity, this response is not inconsistent with reciprocity.

Maine responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Maine further responded that it has a diligent search requirement and that the surplus lines producer is sometimes required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Maine’s response to this question. In subsequent correspondence, Maine stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Maine’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Maine meets the NAIC Reciprocity Standard.

Maryland

Maryland responded “yes” to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident applicants or producers. Maryland explained that it has a statute that provides for disciplinary action against the renewal of a license for any person with a tax delinquency. No additional information is required from the producer and all verification is performed against a Maryland database. Based on this information, this practice is consistent with the NAIC Reciprocity Standard.

Maryland responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Maryland further responded that it has a diligent search requirement and that the surplus lines producer is sometimes required to perform the diligent search of the admitted market. In explanatory comments, Maryland stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Maryland’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Maryland meets the NAIC Reciprocity Standard.

Massachusetts

Massachusetts responded “yes” to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state. Massachusetts added that if a non-resident state offers a combined life and variable life annuity license, it would do the same. The NAIC Reciprocity Standard states that it is inconsistent with reciprocity to require an underlying life license prior to the issuance of a non-resident variable life licenses. In subsequent correspondence, Massachusetts clarified that its practice is to issue automatically a non-resident life license to a non-resident variable life applicant without any additional requirements or fees. Because Massachusetts issues the additional license automatically and without any additional requirements, this practice is not inconsistent with the NAIC Reciprocity Standard.

Massachusetts responded “yes” to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident applicants or producers. In subsequent correspondence, Massachusetts explained that it imposes an E&O insurance requirement for managing general agents and that this requirement is not imposed on insurance producers as a matter of course. Because this requirement is not imposed on producers for whom reciprocity is required, this practice is not inconsistent with reciprocity.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Massachusetts’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Massachusetts meets the NAIC Reciprocity Standard.

Michigan

Michigan responded “yes” to Questions A1 and A2, which asked if there are any requirements or submissions imposed upon a non-resident individual or business entity applicant or producer seeking licensure beyond the requirements included in the Producer Licensing Model Act (PLMA). Michigan further responded that a criminal background check is required on all applicants and that it may be necessary to request additional information from an applicant. The NAIC Reciprocity Standard provides that states may perform background checks or other due diligence without being inconsistent with reciprocity. Further, in subsequent correspondence, Michigan stated that additional information would be required only in those circumstances where the background check uncovered negative information for which licensure may be denied, or where the applicant disclosed negative information on the application and for which the application requests additional information. Michigan does not require additional information to be submitted as a regular licensure practice. Rather, any requested information concerns a matter for which licensure may be denied. Michigan’s practice may have the effect of allowing an applicant to clarify a potentially negative issue and obtain a license. As a result, Michigan’s practice in this area is not inconsistent with the NAIC Reciprocity Standard.

Michigan responded “yes” to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident applicants or producers. Michigan explained that the failure to pay the single business tax or the Michigan business tax or comply with any administrative or court order directing the payment of such tax may provide the basis for denying licensure to an applicant. Michigan does not request additional information as a regular licensure practice, but may request clarifying information if an applicant disclosed that such tax was not paid or that the applicant failed to comply with such orders. Michigan’s practice may have the effect of allowing an applicant to clarify a potentially negative issue and obtain a license. As a result, Michigan’s practice in this area is not inconsistent with the NAIC Reciprocity Standard.

Michigan responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Michigan further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Michigan’s response to this question. In subsequent correspondence, Michigan confirmed that the surplus lines producer is always required to perform the diligent search of the admitted market. Michigan’s practice is consistent with the NAIC Reciprocity Standard.

Michigan responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Michigan stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Michigan’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Michigan meets the NAIC Reciprocity Standard.

Minnesota

Minnesota responded “yes” to Question A2, which asked if there are any requirements or submissions imposed upon a non-resident business entity applicant or producer seeking licensure beyond the four requirements included in the PLMA. Minnesota stated that business entities must designate an individual licensed producer responsible for the business entity’s compliance with Minnesota laws and regulations. In subsequent correspondence, Minnesota explained that this requirement is fulfilled through the application and that an additional submission is not required. With this clarification, the NARAB Working Group does not believe Minnesota’s practice is inconsistent with the reciprocity.

Minnesota responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Minnesota further responded that it has a diligent search requirement and that the surplus lines producer is required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Minnesota’s response to this question. In subsequent correspondence, Minnesota stated it would not impose any underlying license requirements on surplus lines applicants or producers who are licensed for surplus lines in their home states and who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Minnesota's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Minnesota meets the NAIC Reciprocity Standard.

Mississippi

Mississippi responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Mississippi further responded that it has a diligent search requirement and that the surplus lines producer is required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Mississippi's response to this question. Subsequently, Mississippi reported the enactment of a new statutory provision eliminating the underlying general lines or P&C license requirement if the surplus lines applicant or producer is not required to perform the diligent search of the admitted market. Mississippi confirmed this exception would apply if the surplus lines producer relies on a diligent search performed by a producer properly licensed to do so. As revised, Mississippi's practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Minnesota's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Minnesota meets the NAIC Reciprocity Standard.

Montana

Montana responded "yes" to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state. In subsequent correspondence, Montana stated this requirement had been removed. As a result, Montana's practice in this area is consistent with the NAIC Reciprocity Standard.

Montana responded "yes" to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident applicants or producers. In subsequent correspondence, Montana clarified that it imposed none of these specific requirements on non-residents.

Montana responded "yes" to Question E3, which asked if non-resident surplus lines applicants or producers required to post a bond. In subsequent correspondence, Montana clarified that it does not impose a bond requirement on non-resident surplus lines applicants or producers.

Montana responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Montana further responded that it had a diligent search requirement and that the surplus lines producer is sometimes required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Montana's response to this question. In subsequent correspondence, Montana stated it would apply the reciprocity provisions of its producer licensing code for non-resident surplus lines licensure.

Montana responded "yes" to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. In subsequent correspondence, Montana stated its original response applied to resident producers and confirmed it did not impose the aforementioned requirements on non-resident applicants.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Montana's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Montana meets the NAIC Reciprocity Standard.

Nebraska

Nebraska responded "yes" to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident applicants or producers. Nebraska indicates that it imposed a financial responsibility requirement on all viatical settlement brokers and viatical settlement broker entities. Because the NAIC Reciprocity Standard provides that viatical settlement brokers are not entitled to reciprocity, this practice is not inconsistent with reciprocity.

Nebraska responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Nebraska further responded that it had a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Nebraska’s response to this question. In subsequent correspondence, Nebraska stated it would not impose any underlying license requirements on surplus lines applicants or producers who hold the underlying P&C license in their home state. Because all states require their resident surplus lines producers to hold resident P&C licenses, this practice is not inconsistent with reciprocity as applied. In the event another reciprocal jurisdiction eliminated its underlying license requirement for residents while still offering reciprocity to other jurisdictions, Nebraska’s practice may need to be revisited for consistency with reciprocity.

Nebraska responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Nebraska stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Nebraska’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Nebraska meets the NAIC Reciprocity Standard.

Nevada

Nevada responded “yes” to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state. In subsequent correspondence, Nevada clarified that this requirement has been removed. As a result, Nevada’s practice in this area is consistent with the NAIC Reciprocity Standard.

Nevada responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Nevada stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Nevada’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Nevada meets the NAIC Reciprocity Standard.

New Hampshire

New Hampshire’s responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of New Hampshire’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes New Hampshire meets the NAIC Reciprocity Standard.

New Jersey

New Jersey’s responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of all other aspects of New Jersey’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes New Jersey meets the NAIC Reciprocity Standard.

North Carolina

North Carolina responded “yes” to Question A1, which asked if there are any requirements or submissions imposed upon a non-resident producer seeking licensure beyond the four requirements included in the PLMA. North Carolina stated there is a requirement that all producers who sell, solicit or negotiate long-term care or Medicare Supplement insurance must obtain a separate limited lines license in addition to the accident and health or sickness line of authority. In subsequent correspondence, North Carolina clarified that, if a non-resident producer’s accident and health or sickness license in the producer’s home state encompasses authority sell, solicit or negotiate long-term care or Medicare Supplement insurance, North Carolina’s practice is to issue automatically a non-resident long-term care/Medicare Supplement insurance limited lines license without imposing any further requirements on the non-resident applicant beyond the uniform application and fee. Because North Carolina issues the additional license automatically and without any additional requirements, this practice is not inconsistent with the NAIC Reciprocity Standard.

Also in response to Question A1, North Carolina disclosed that non-resident producers seeking a variable life license are required to also obtain a life license from the state. In subsequent correspondence, North Carolina confirmed that this requirement had been removed. As a result, North Carolina's practice in this area is consistent with the NAIC Reciprocity Standard.

North Carolina responded "no" to Question C1, which asked if a non-resident license will be granted for at least the same scope of authority as the non-resident producer applicant's home state license. North Carolina disclosed the same long-term care and Medicare Supplement insurance limited lines license requirement discussed above, which is not inconsistent with the NAIC Reciprocity Standard.

North Carolina responded "yes" to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from your state. As discussed above, this requirement was subsequently eliminated, with the result that North Carolina's practice in this area is consistent with the NAIC Reciprocity Standard.

North Carolina responded "yes" to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. North Carolina stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

North Carolina responded "yes" to Question F, which asked if there are any post-licensing or other regulatory requirements on any non-resident producer that limit or condition the non-resident producer's activities because of such producer's residence or place of operations, or that otherwise subject the non-resident producer to different or discriminatory regulatory requirements than those imposed upon residents. North Carolina stated that every report of surplus lines business placed by a non-resident producer must be countersigned by a resident license or by a regulatory support organization. In subsequent correspondence, North Carolina clarified that policy countersignature is not required. Additionally, GLBA § 6751(c)(3) specifically finds that countersignature requirements imposed on nonresident producers are not deemed to have the effect of limiting or conditioning a producer's activities because of its residence or place of operations. As a result, North Carolina's practice in this area is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above items on its Reciprocity Checklist and following the review of other relevant aspects of North Carolina's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes North Carolina meets the NAIC Reciprocity Standard.

North Dakota

North Dakota responded "yes" to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. North Dakota further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning North Dakota's response to this question. In subsequent correspondence, North Dakota stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of North Dakota's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes North Dakota meets the NAIC Reciprocity Standard.

Ohio

Ohio's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Ohio's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Ohio meets the NAIC Reciprocity Standard.

Oklahoma

Oklahoma's responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Oklahoma's non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Oklahoma meets the NAIC Reciprocity Standard.

Oregon

While Oregon responded “no” to Question E1, which asked whether an appointment is required prior to on concurrent with licensure, Oregon disclosed that an appointment must be secured before transacting business. Because Oregon does not require an appointment as a pre-licensing requirement and companies, rather than producers, bear the burden of submitting appointments, this requirement is consistent with the NAIC Reciprocity Standard.

Oregon responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Oregon further responded that it had a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Oregon’s response to this question. In subsequent correspondence, Oregon stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

Oregon responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Oregon stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Oregon’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Oregon meets the NAIC Reciprocity Standard.

Rhode Island

Rhode Island responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Rhode Island further responded that it had a diligent search requirement and that the surplus lines producer is sometimes required to perform the diligent search of the admitted market. Additionally, an interested party submitted a comment letter concerning Rhode Island’s response to this question. In subsequent correspondence, Rhode Island confirmed it removed the underlying license requirement for non-resident surplus lines applicants and producers.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Rhode Island’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Rhode Island meets the NAIC Reciprocity Standard.

South Carolina

South Carolina responded “no” to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state, but subsequently disclosed that the underlying life license requirement remained in place. South Carolina later confirmed that the underlying life license requirement was removed for non-resident variable life applicants. As a result, South Carolina’s practice in this area is consistent with the NAIC Reciprocity Standard.

South Carolina responded “no” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants, but also disclosed there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of South Carolina’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes South Carolina meets the NAIC Reciprocity Standard.

South Dakota

South Dakota responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. South Dakota further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of South Dakota’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes South Dakota meets the NAIC Reciprocity Standard.

Utah

While Utah responded “no” to Question A1, which asked if there are any requirements or submissions imposed upon a non-resident producer seeking licensure beyond the four requirements included in the PLMA, Utah disclosed two practices concerning its response. First, Utah stated it does not specifically require that the non-resident’s home state also extend reciprocity to Utah residents. The NARAB Working Group does not believe the lack of this requirement to be inconsistent with the NAIC Reciprocity Standard. Second, Utah stated that it required the applicant to execute a form whereby the applicant agrees to be subject to the jurisdiction of the Utah insurance commissioner for that applicant’s activities in Utah. In subsequent correspondence, Utah explained that this requirement is fulfilled through the application and that an additional submission is not required. With this clarification, the NARAB Working Group does not believe Utah’s practice is inconsistent with the NAIC Reciprocity Standard.

While Utah responded “yes” to Question D, which asked if a non-resident producer’s continuing education requirement is met if the non-resident producer fulfills his or her home state continuing education requirement and the home state also grants such reciprocity, Utah stated it does not require reciprocity from the non-resident’s home state in order for the non-resident licensee to be deemed to satisfy Utah’s continuing education requirements. Because Utah does not impose continuing education requirements on non-residents that otherwise would be imposed in the absence of reciprocity, this response is not inconsistent with reciprocity.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Utah’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Utah meets the NAIC Reciprocity Standard.

Vermont

Vermont responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Vermont further responded that it has a diligent search requirement and that the surplus lines producer is always required to perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of Vermont’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Vermont meets the NAIC Reciprocity Standard.

Virginia

Virginia responded “yes” to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state. In subsequent correspondence, Virginia confirmed this requirement had been removed through a legislative change that took effect after its Reciprocity Checklist was submitted. As a result, Virginia’s practice in this area is consistent with the NAIC Reciprocity Standard.

Virginia responded “no” to Question D, which asked if a non-resident producer’s continuing education requirement is met if the non-resident producer fulfills his or her home state continuing education requirement and the home state also grants such reciprocity. Virginia stated non-resident producers are exempt from Virginia continuing education requirements if they are compliant with home state continuing education requirements and pay the licensing continuation fee to Virginia. Because

Virginia does not impose continuing education requirements on non-residents that otherwise would be imposed in the absence of reciprocity, this response is not inconsistent with the NAIC Reciprocity Standard.

Virginia responded “yes” to Question E2, which asked if there are any bond, E&O, deposit, tax clearance or trust account requirements for non-resident producers. Virginia stated all producers must maintain a fiduciary account for all funds received. In subsequent correspondence, Virginia explained this requirement is not applied in a manner that requires non-resident producers to establish an account with a Virginia financial institution. As a result, Virginia’s practice in this area is consistent with the NAIC Reciprocity Standard.

Virginia responded “yes” to Question E5, which asked if there are any training, education, prior experience or minimum age requirements for non-resident producers or applicants. Virginia stated there is a requirement that a producer be 18 years old. This requirement is consistent with the NAIC Reciprocity Standard.

As a result of the clarifications to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Virginia’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Virginia meets the NAIC Reciprocity Standard.

West Virginia

West Virginia responded “yes” to Question C2, which asked whether a state requires a non-resident applicant seeking a variable life license to also obtain a life license from the state. In subsequent correspondence, West Virginia stated this requirement has been removed. As a result, West Virginia’s practice in this area is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above item on its Reciprocity Checklist and following the review of other relevant aspects of West Virginia’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes West Virginia meets the NAIC Reciprocity Standard.

Wisconsin

Wisconsin’s responses to the Reciprocity Checklist raised no issues requiring specific follow-up. Following the review of other relevant aspects of Wisconsin’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Wisconsin meets the NAIC Reciprocity Standard.

Wyoming

Wyoming responded “yes” to Question E4a, which asked if non-resident surplus lines applicants or producers are required to obtain an underlying general lines or P&C license as a condition to surplus lines licensure. Wyoming further responded that it had a diligent search requirement and that the surplus lines producer is sometimes required to perform the diligent search of the admitted market; however, Wyoming indicated that an underlying license had been waived through Memorandum 01-2010. An interested party submitted a comment letter concerning underlying license requirements imposed by Wyoming. In subsequent correspondence, Wyoming stated it would not impose any underlying license requirements on surplus lines applicants or producers who do not perform the diligent search of the admitted market. This practice is consistent with the NAIC Reciprocity Standard.

As a result of the clarification to the above items on its Reciprocity Checklist and following the review of other relevant aspects of Wyoming’s non-resident producer licensing laws, regulations and practices, the NARAB Working Group believes Wyoming meets the NAIC Reciprocity Standard.

APPENDIX A

REPORT OF THE NARAB WORKING GROUP

**CONTINUING COMPLIANCE WITH RECIPROCITY REQUIREMENTS
OF THE GRAMM-LEACH-BLILEY ACT**

ADOPTED 6-15-09

The purpose of this report is to present to the NAIC membership an updated framework for determining the continuing compliance of the states with the producer licensing reciprocity requirements of the Gramm-Leach-Bliley Act (GLBA), 15 U.S.C. §§ 6751 et seq. This report is also intended to meet the following charge to the NARAB Working Group:

Finalize the evaluation of the reciprocity standard developed by the NAIC's 2002 NARAB (EX) Working Group and make final recommendations by the 2009 Summer National Meeting for revisions or additions to the standard to address the issues identified in the Producer Licensing Assessment Aggregate Report of Findings including the various state requirements that are imposed upon non-residents but may not have been specifically addressed in the 2002 reciprocity standard.

As detailed herein, the Working Group reviewed several subjects relevant to non-resident producer licensing to determine their conformity with the 2002 standard. Our conclusions are stated below. In order to have all relevant guidance in one document, we have reproduced, and thereby reaffirmed, certain conclusions from the 2002 reciprocity standard. To achieve consistency and clarity, much of the information in this report is re-produced from previous materials.

The Working Group makes no finding concerning continuing compliance of any state with the 2002 standard, as updated and supplemented today. This report will provide the basis for initiating a formal reassessment of state compliance with the reciprocity framework.

EXECUTIVE SUMMARY

The specific analysis related to individual topics is detailed below, but the Working Group has determined the following requirements imposed on non-resident producers or applicants are inconsistent with GLBA reciprocity:

- Fingerprint requirements;
- Requiring a surplus lines producer not required to perform or not performing the diligent search of the admitted market to obtain an underlying general lines license;
- Surplus lines bonds;
- Requiring the designated responsible producer to be appointed prior to the issuance of a non-resident business entity license;
- Requiring the business entity to submit articles of incorporation;
- Requiring an underlying life license prior to the issuance of a variable life license;
- Requiring individuals seeking a fraternal license to have a fraternal certificate from a company;
- Requiring the submission of additional information to verify an applicant's age;
- Offering inconsistent terms of licensure for residents and non-residents; and
- Requiring trust accounts as a condition to licensure or applying trust account requirements against non-residents in a discriminatory manner;

The Working Group does not believe the following requirements are inconsistent with GLBA reciprocity:

- Performing background checks or other due diligence without requiring additional submissions by the applicant;
- Requiring a surplus lines producer required to perform or performing the diligent search of the admitted market to obtain an underlying general lines license;
- Appointments not required during the licensing process;
- Requiring the designated responsible producer to be licensed prior to the issuance of a non-resident business entity license, provided the applications are accepted concurrently;
- Requiring a business entity to register to do business in the state;

- Requesting proof of Secretary of State registration as a prerequisite for business entity licensure;
- Not adopting the major lines of authority definitions of the Producer Licensing Model Act;
- Verifying legal work authorization for non-U.S. citizen applicants;
- Enforcing minimum age requirements;
- Non-discriminatory trust account requirements of general application if not tied to licensure or applied discriminatorily against non-residents;
- Verifying an applicant for license renewal has paid all undisputed taxes and unemployment insurance contributions;
- Continuing education requirements based on federal mandates; and
- Not offering reciprocal licensing treatment to viatical settlement brokers.

The above lists are, by no means, exhaustive of the licensing and regulatory issues that may impact reciprocity. These are, however, the issues upon which the NARAB Working Group has opined. As new issues are brought to our attention, we will analyze such issues under the reciprocity standard described in this report.

BACKGROUND

Following passage of GLBA in 1999, the NAIC established the NARAB Working Group in order to interpret and apply the producer licensing reciprocity requirements of GLBA, determine which states were compliant therewith, and make a report with recommendations to that effect. The details of the NARAB provisions of GLBA are stated in the next section of this report.

On August 8, 2002, the NARAB Working Group adopted the *Report of the NARAB Working Group: Certification of States for Producer Licensing Reciprocity* (“2002 Report”), which established a reciprocity framework and recommended that 35 states be certified as reciprocal jurisdictions. Since the adoption of the 2002 Report, 12 additional jurisdictions have been certified as reciprocal, raising the total number of reciprocal jurisdictions to 47. The NARAB Working Group was disbanded in September 2002, and the Producer Licensing Working Group (PLWG) became the focal point for uniformity efforts in producer licensing.

In 2007, the NAIC commenced a producer licensing assessment process intended to review continuing GLBA reciprocity and compliance with the NAIC’s Uniform Resident Licensing standards. The assessment process included a comprehensive and searching analysis of state producer licensing procedures involving an initial self-assessment, peer review, and direct Commissioner or senior insurance department staff engagement. This state-by-state review culminated in the *NAIC Producer Licensing Assessment Aggregate Report of Findings* (“Producer Licensing Assessment Report”), which was issued on February 19, 2008. With respect to reciprocity, the Producer Licensing Assessment Report determined that all states previously certified as GLBA-compliant remained compliant with the standard established in the 2002 Report. The Producer Licensing Assessment Report also identified various requirements imposed upon non-residents that were not specifically addressed within the 2002 Report. The NAIC re-constituted the NARAB (EX) Working Group in order to determine whether these requirements impacted reciprocity. The Working Group, in turn, engaged the NAIC Legal Division to provide legal analysis of these issues.

On May 23, 2008, the NAIC Legal Division provided the NARAB Working Group with memorandum on “Additional Issues Identified in Producer Licensing Assessment Report” (“May 2008 Memorandum”). The May 2008 Memorandum provided recommendations to the NARAB Working Group as to whether the issues noted in the Producer Licensing Assessment Report impacted reciprocity. By conference call on June 26, 2008, the NARAB Working Group adopted the recommendations contained within the memorandum. The May 2008 Memorandum noted that the NARAB Working Group received written comments from regulators and interested parties identifying additional possible reciprocity issues not addressed in the Producer Licensing Assessment Report. In a legal memorandum dated November 19, 2008 on “Additional Potential Reciprocity Issues Raised in Written Comments” (“November 2008 Memorandum”) the NAIC Legal Division analyzed the possible reciprocity impact of these additional items. In some areas, the November 2008 Memorandum provided a recommendation; in other areas, additional information and study was required. The Working Group’s determination of the impact of these latter matters upon reciprocity is stated within this report.

In meeting our charge to “make final recommendations by the 2009 Summer National Meeting for revisions or additions to the [2002 reciprocity] standard,” the NARAB Working Group has utilized the 2002 Report, the Producer Licensing Assessment Report, the May 2008 Memorandum, the November 2008 Memorandum, regulator and interested party comments, and other additional research. Our intent is not to establish a new reciprocity standard. Rather, in adopting this

report, we restate and reaffirm the basic analytical framework within the 2002 Report and supplement that reciprocity standard by applying it to issues not considered by our predecessor working group. The Working Group intends this report to provide greater clarity to the NAIC's reciprocity standard. Upon NAIC adoption of this report, the NARAB Working Group will initiate a formal re-evaluation of state compliance with GLBA reciprocity utilizing the findings of this report in doing so.

NARAB PROVISIONS OF GLBA

GLBA requires that at least 29 jurisdictions meet the uniformity or reciprocity requirements of 15 U.S.C. § 6751 by November 12, 2002, in order to avoid the preemption of certain state producer licensing laws and the establishment of the National Association of Registered Agents and Brokers. The NAIC elected to pursue the reciprocity option with uniformity remaining the long-term goal for non-resident (and resident) producer licensing. Thus, pursuant to 15 U.S.C. § 6751(a)(2), a minimum of 29 jurisdictions must have enacted "reciprocity laws and regulations governing the licensure of nonresident individuals and entities authorized to sell and solicit insurance within those States" by November 12, 2002.

According to the reciprocity standard developed by the 2002 NARAB Working Group and included in the 2002 Report, a state must satisfy the following four conditions in order to be considered reciprocal for non-resident producer licensing under 15 U.S.C. § 6751(c) of GLBA:

- (1) Permit a producer with a resident license for selling and soliciting insurance in its home state to receive a license to sell or solicit the purchase of insurance as a non-resident to the same extent that the producer is permitted to sell or solicit insurance in its home state, if the home state also licenses reciprocally, without satisfying any additional requirements other than submitting (A) a request for licensure; (B) the application for licensure submitted to the home state; (C) proof of licensure and good standing in home state; and (D) payment of any requisite fee;
- (2) Acceptance of a producer's satisfaction of its home state's continuing education requirements as satisfying that state's continuing education requirements, provided that the home state recognizes continuing education satisfaction on a reciprocal basis;
- (3) No requirements are imposed upon any producer to be licensed or otherwise qualified to do business as a non-resident that have the effect of limiting or conditioning that producer's activities because of its residence or place of operations (excepting countersignature requirements); and
- (4) Each state meeting (1), (2) and (3) grants reciprocity to residents of all other states that satisfy (1), (2) and (3).

Additionally, the savings provision of Section 15 U.S.C. § 6751(f) provides that state laws or regulations purporting to regulate insurance producers (including laws on unfair trade practices, consumer protections, and countersignatures) need not be altered or amended for purposes of satisfying the reciprocity criteria unless that law or regulation is inconsistent with a specific requirement noted above and only to the extent of the inconsistency. While unfair trade practices and consumer protection laws are specifically mentioned, these types of laws are afforded no heightened protection and also are subject to the requirement of consistency with 15 U.S.C. § 6751(c). The savings provision should be construed in such a way as to allow state laws regulating producers generally to be saved while still achieving the Congressional intent to streamline licensing procedures and prevent discrimination against non-resident producers.

Under 15 U.S.C. § 6751(d)(1), the NAIC was required to determine whether the requisite number of states achieved reciprocity. As stated, the earlier NARAB Working Group was assigned the task of interpreting and applying the reciprocity requirements under GLBA, determining which states were compliant therewith, and making its report along with recommendations to its parent committee.

The expertise of the state insurance regulators in determining whether states meet reciprocity is recognized under 15 U.S.C. § 6751(d)(2). In the event of a legal challenge to the NAIC's conclusion, 15 U.S.C. § 6751(d)(2) provides that the reviewing court shall apply the standards set forth in the Administrative Procedure Act. In relevant part, this statute states that a determination will not be overturned unless it found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. § 706(2)(A). Furthermore, case law indicates that a reviewing court will consider three factors in examining a determination: scope of authority, whether the determination was arbitrary and capricious, and whether the decision-making process was procedurally valid. *Chevron, U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984); *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971), *overruled on other grounds*, *Califano v. Sanders*, 430 U.S. 99 (1977). The Working Group believes that its process for considering reciprocity issues in

2002 and today meets the criteria established for affording deference to the NAIC's reciprocity standard and determinations of state compliance therewith.

GLBA ANALYSIS OF SPECIFIC ISSUES

In 2002 and today, the NARAB Working Group has analyzed whether states may impose certain requirements on non-residents and remain compliant with GLBA reciprocity. The Working Group recognizes that many of these requirements are imposed in good faith as part of a state's consumer protection regime. Where such requirements appear to go beyond the letter of 15 U.S.C. § 6751(c), the Working Group has considered whether the requirements may be maintained as consistent with GLBA. In 2002 and today, the Working Group has utilized the expertise of state producer licensing directors, other interested regulators, the NAIC Legal Division and interested parties in developing a recommendation about the consistency of these requirements with reciprocity.

Following this introductory section is an issue-by-issue analysis of certain specific issues within the context of GLBA reciprocity. In some cases, we have re-produced in substantial part the recommendations of our predecessor NARAB Working Group. In doing so, we intend to reaffirm those findings by incorporating them directly within the report we adopt today.

A. Fingerprints and Background Checks

The following is re-produced, in substantial part, from the 2002 Report:

The Working Group addressed the issue of the due diligence states may perform in reviewing the qualifications of a non-resident applicant, including whether states may require fingerprints of non-resident applicants. With respect to state review of application materials, the Working Group determined that GLBA affords states the opportunity to determine that an applicant meets a particular state's qualifications for licensure, provided such due diligence required no additional submissions beyond the items permitted by 15 U.S.C. § 6751(c)(1). Therefore, the Working Group believes that states may perform background checks or other due diligence without being inconsistent with reciprocity.

During the course of its discussions, the Working Group considered whether fingerprints may be required as a means of performing an effective review of the applicant's qualifications. Within the context of reciprocity, the principal argument favoring a fingerprint requirement was that GLBA protected this requirement as an important consumer protection through application of the savings clause of 15 U.S.C. § 6751(f), and that fingerprints provide the most effective means of performing a background check. Arguments against fingerprints as a permissible requirement also focused on the savings provision and questioned whether such a requirement is "consistent" with the provisions of 15 U.S.C. § 6751(c).

After careful review, analysis, and extensive debate, the Working Group adopted the position that a fingerprint requirement for non-resident producer applicants is inconsistent with the reciprocity requirements under GLBA. 15 U.S.C. § 6751(c)(1) provides that non-resident producers be permitted to receive a license "without satisfying any additional requirements other than submitting" a request for licensure, the home state application or Uniform Application, proof of licensure and good standing in the home state, and the payment of required fees. After considering several alternatives for allowing fingerprints within the GLBA reciprocity formula, the Working Group determined that pre-licensing fingerprint requirements for non-resident producers constituted an "additional requirement" which is inconsistent with reciprocity under 15 U.S.C. § 6751(c)(1).

B. Surplus Lines Issues

1. Underlying Licensing Requirements for Surplus Lines Producers

In response to comments from interested parties, the Working Group evaluated whether states requiring non-residents to obtain non-resident general lines producer licenses – namely, property and casualty licenses – as a prerequisite to surplus lines licensure is inconsistent with GLBA reciprocity. This issue was addressed in the 2002 Report, which concluded that requiring a general lines license relates to regulation of the surplus lines market and was not an additional administrative requirement being imposed on non-residents. This conclusion was based on the following analysis:

As part of its analysis, the Working Group recognized the unique nature of the surplus lines market, relative to general lines of authority such as life and property. Surplus lines brokering is a specialized insurance

producer function whereby producers secure insurance coverage generally unavailable from carriers licensed in that jurisdiction

Almost all States require resident surplus lines producers to first obtain a license to act as a general lines producer. **Generally, surplus lines producers must first search the admitted market as a prerequisite to searching the non-admitted market. Thus, both general lines *and* surplus lines authority are required in order to operate as a surplus lines producer.** In many cases, the rationale for the admitted market prerequisite is generally one of consumer protection. The surplus lines insurer, being a non-admitted carrier, is not subject to the jurisdiction of insurance regulatory authorities in that State. Further, there is typically no guaranty fund coverage for risks insured in the non-admitted market. Many States require that insureds be notified of these facts.

In the non-resident licensing context, the question is whether a State requirement that non-residents obtain both general lines and surplus lines authority is an administrative or regulatory requirement. The Working Group concluded that requiring a general lines license relates to regulation of the surplus lines market and is not an additional administrative requirement being imposed on non-residents. **The general lines license gives the non-resident producer the authority, otherwise lacking, to search for coverage within the admitted market.** Generally speaking, without this authority, a surplus lines producer would be unable to fulfill his or her duty to first attempt to place business in the admitted market. Thus, the general lines license gives effect to the surplus lines license. Many States issue these two licenses in tandem. (Emphasis added.)

Interested parties recently commented that the factual premise upon which the NARAB Working Group reached this conclusion was flawed. In 2002, the Working Group appeared to have assumed that all surplus lines producers would be required to conduct diligent searches of the admitted market. Accordingly, the Working Group adopted an approach that states could require surplus lines producers to obtain an underlying general lines producer license as a condition to licensure as a non-resident surplus lines producer. Because it appears that all surplus lines producers are not required in all states and in all situations to conduct the diligent search, we have considered whether states may impose underlying general lines license requirements upon those non-resident surplus lines producers not conducting the diligent search.

In urging our re-consideration of the factual premise supporting the 2002 Report, the National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) pointed to the example of the wholesale business model by which many surplus lines transactions are accommodated. In this model, surplus lines producers are generally brought into the transaction *after* a general lines producer has already made a diligent search of the admitted market and has been unable to obtain traditional admitted insurance. NAPSLO further argued that the surplus lines producer often is not specifically required under state law to conduct its own search, such that a general lines license would not be necessary.

The potential reciprocity issue presented by the requirement that a surplus lines producer hold an underlying non-resident general lines license as a prerequisite to qualify for non-resident surplus lines licensure arises when the non-resident surplus lines applicant is not required to and does not perform the diligent search of the admitted market in the non-resident state. In this example, the general lines license requirement could result in the applicant being forced to qualify for a line of authority not sought – and not needed - from the non-resident state.

In providing a legal analysis of this issue in November 2008, the NAIC Legal Division noted that state laws and practices varied with respect to diligent search requirements. While many states appeared to permit the general lines producer to conduct or certify the diligent search, there were some states that required the surplus lines producer to perform the diligent search.

The Working Group recently surveyed state producer licensing directors and general counsels in order to determine which states required an underlying general lines license as a condition to licensure as a surplus lines producer and upon whom states imposed the requirement to conduct the diligent search. The results of this survey indicated a variance among state laws and practices, such that states appeared to fall into the following broad categories:

- (1) States that do not require a non-resident surplus lines producer to obtain an underlying general lines license;
- (2) States that require a non-resident surplus lines producer to obtain an underlying general lines license and specifically require the surplus lines producer to conduct the diligent search of the admitted market; and

- (3) States that require a non-resident surplus lines producer to obtain an underlying general lines license but impose the diligent search requirement upon the underlying producer in the transaction or upon the “producing broker.”

From this analysis, it is apparent that state underlying license and diligent search requirements are not as clear or as uniform as may have been understood in 2002. In adopting an approach to be utilized as part of an updated and ongoing reciprocity framework, the Working Group returns to the premise of its 2002 Report; that is, if a non-resident surplus lines producer is conducting the diligent search of the admitted market, the producer is performing both the surplus lines and general lines functions. It is not inconsistent with GLBA reciprocity to require the producer to secure authority to act as a general lines producer prior to performing this function. Provided the general lines producer license was also issued consistently with reciprocity requirements, the Working Group does not believe such an approach would be inconsistent with GLBA.

Returning to the categories listed above, the Working Group sees no reciprocity issues for states within categories (1) and (2). Where the state imposes no general lines producer licensing requirement, this issue is not present. Where states require the surplus lines producer to conduct the diligent search, the Working Group believes that state is justified in imposing an underlying general lines producer license requirement and that such requirement is not inconsistent with GLBA reciprocity for reasons stated in the 2002 Report.

For states falling within category (3), the Working Group is concerned about imposing underlying license requirements upon surplus lines producers who are not required by law or practice to conduct the diligent search. If the surplus lines producer is not conducting the diligent search, there does not appear to be another justifiable reason for imposing such requirement consistent with GLBA reciprocity.

The Working Group is mindful that some states may have adopted underlying license requirements for non-resident surplus lines producers in reliance on the 2002 Report, but we believe this clarification is necessary to preserve a reciprocity framework consistent with GLBA. For these states, the Working Group notes that we believe it would be consistent with reciprocity to continue to require underlying licenses for those surplus lines producers actually conducting the diligent search. For those surplus lines producers not performing the diligent search, we urge states to examine their statutes for provisions similar to Sections 8D and 16A of the Producer Licensing Model Act (PLMA) for authority to waive or otherwise remove any underlying license requirements. Section 8D of the PLMA provides that “[n]otwithstanding any other provision of this Act, a person licensed as a surplus lines producer in his or her home state shall receive a nonresident surplus lines producer license [by satisfying the four requirements listed in Section 8A of the PLMA].” Section 16A of the PLMA states that “[t]he insurance commissioner shall waive any requirements for a nonresident license applicant with a valid license from his or her home state, except the requirements imposed by Section 8 of this Act, if the applicant’s home state awards nonresident licenses to residents of this state on the same basis.” Further, the Working Group is willing to assist in developing a model bulletin for use by states in explaining any changes in interpretation or application of laws or procedures necessary to accommodate reciprocity requirements.

We note our opinion is limited to the issue of underlying license requirements for non-resident surplus lines producers. It should not be construed to raise questions about a state’s regulation of its surplus lines market through non-discriminatory application of general regulatory requirements, such as the filing of certifications or attestations about surplus lines transactions and premium tax reporting.

2. Surplus Lines Bonds

The following is re-produced, in substantial part, from the 2002 Report:

The Working Group examined the use of surplus lines bonds as both a pre- and post-licensing non-resident requirement. As a pre-licensing requirement, the Working Group determined that a surplus lines bond is inconsistent with reciprocity under GLBA. A consumer protection justification was not found to be available within the context of reciprocity. The savings provision is not a broad exemption for laws based upon a valid consumer protection justification. Rather, 15 U.S.C. § 6751(f) saves laws generally — including those related to consumer protection — provided they do not violate a specific requirement of the reciprocity provisions of 15 U.S.C. § 6751(c). The Working Group determined that a pre-licensing surplus lines bond is inconsistent with 15 U.S.C. § 6751(c), i.e., a pre-licensing surplus lines bond is an “additional requirement” and, therefore, states imposing such a requirement do not satisfy reciprocity under 15 U.S.C. § 6751(c)(1).

Likewise, with respect to post-licensing surplus lines bonds, the Working Group determined that these post-licensing requirements, which condition the use of the license on having such a bond in place, are inconsistent with GLBA reciprocity. The Working Group found that such a bond would be a de facto licensing requirement due to the inability of the producer to use the license without first posting a bond.

C. Appointments

1. Appointments and “Agent-Only” States

The following is re-produced, in substantial part, from the 2002 Report:

The Working Group identified states that do not recognize brokering activities in the sense that all producers/“agents” are agents of the insurer and thus require that producers/“agents” be appointed by an insurer even though such a requirement ordinarily may not exist for “brokers.” As a general rule, the Working Group believes that appointments are permissible under GLBA as long as they are not required as part of the licensing process. The “agent-only” states do not require an appointment as a pre-licensing requirement, thereby avoiding the imposition of an additional requirement to licensure. Furthermore, appointment requirements are imposed upon companies, rather than producers, thus removing the burden from the producer seeking licensure. Accordingly, the Working Group did not find the imposition of such an appointment requirement to be inconsistent with reciprocity.

2. Requiring the Designated Responsible Producer (DRP) to be Licensed or Appointed Prior to the Issuance of a Non-Resident Business Entity License

The Working Group believes that requiring the DRP to be appointed prior to the issuance of a non-resident business entity license is inconsistent with GLBA reciprocity requirements.

GLBA does not distinguish between individuals and business entities with respect to the requirements that a reciprocal state may impose. The general reciprocity framework has been accepted to apply to business entity licensing as well as individual producer licensing. Therefore, to the extent a state conditions the acceptance of a non-resident business entity application on an additional submission as to the licensure status of the business entity’s DRP, this practice would be inconsistent with GLBA reciprocity requirements.

The designation of a licensed producer responsible for the business entity’s compliance with a state’s insurance laws, rules and regulations stems from Section 6B(2) of the PLMA. This provision requires the commissioner to find the DRP has been designated “before approving the [business entity’s] application.” The DRP requirement serves to attach responsibility for regulatory enforcement issues to the individual DRP in addition to the associated business entity. Potential inconsistency with GLBA reciprocity arises if states inadvertently create a *de facto* additional submission requirement by barring the concurrent submission of business entity and DRP applications for licensure. In other words, the practice of requiring the DRP’s individual application to be submitted and approved separately prior to the business entity’s application creates the appearance of an impermissible additional submission requirement for the business entity application.

The potential reciprocity issue is remedied when states accept the business entity’s application and the DRP’s individual application at the same time. Clearly, the individual application must be processed first to ensure that the DRP is, in fact, licensed. As stated in the Producer Licensing Assessment Report, states should ensure there is a method of concurrent licensure and work to facilitate the licensing of a business entity and DRP at the same time. While requiring the DRP to be licensed prior to the issuance of a non-resident business entity license is a potential violation of the GLBA reciprocity requirements, the NARAB Working Group believes it is easily remedied by attention to the timing with which business entity and DRP applications are accepted for processing. Accepting business entity and DRP applications concurrently would be consistent with GLBA reciprocity.

With regard to requiring a business entity’s DRP to be appointed by a carrier prior to the issuance of a non-resident business entity license, the 2002 Report found that, generally, appointments are permitted under GLBA provided they are not required as part of the licensing process. There appears to be no statutory or administrative basis for conditioning a business entity’s licensure on the submission of appointment documentation for an individual producer, especially given that companies rather than producers are subject to appointment requirements. Therefore, the Working Group believes that requiring the DRP to be appointed prior to the issuance of a non-resident business entity license is inconsistent with GLBA reciprocity requirements.

D. Non-Resident Business Entity Licensing Issues

1. Requirement for Foreign Corporation to Register with Secretary of State to do Business in Another State

The Working Group believes that requiring a non-resident business entity to register to do business in the state is not inconsistent with GLBA reciprocity requirements. The Working Group further believes that requests for proof of Secretary of State corporate registration as a prerequisite for non-resident business entity licensing is also not inconsistent with GLBA reciprocity requirements.

This issue was addressed in the 2002 Report, which included the following analysis:

Corporate registration requirements are matters of State corporate law, whereby States require all business entities (not just those that are insurance-related) to register with the Secretary of State or an equivalent office. The Working Group believes that such requirements transcend issues of insurance licensing and relate to basic police powers of States to require registration of business entities. Thus, this requirement is not inconsistent with reciprocity.

No new facts or inconsistencies have been presented in the comments which would lead to the determination that the earlier conclusion of the 2002 NARAB Working Group was either incorrect or inappropriate. Absent any new information to consider, the Working Group is not inclined to alter its approach on this issue.

With respect to the practice of requiring proof of foreign corporation registration to do business in another state, we believe that this also relates to the basic police powers of the states and is not inconsistent with reciprocity. Nevertheless, NAIC members, the Working Group and PLWG have encouraged states to develop alternative means to verify this registration to ease the administrative burden on business entity applicants; e.g., direct electronic verification with the Secretary of State. Continued elimination of requests for proof of Secretary of State corporate registration as a prerequisite for non-resident business entity licensing was identified in the Producer Licensing Assessment Report as an issue that continues to necessitate Commissioner-level attention so that progress can be measured and nationwide elimination of this prerequisite as an insurance department licensing requirement is achieved. Therefore, while this practice is actively being discouraged by NAIC membership, the NARAB Working Group does not believe it is inconsistent with GLBA reciprocity requirements.

2. Requiring a Non-Resident Business Entity to Submit Articles of Incorporation

The Working Group believes that requiring a non-resident business entity to submit articles of incorporation is inconsistent with GLBA reciprocity requirements.

Organizational document requirements typically arise in conjunction with the concept of Secretary of State registration. The NAIC membership has worked actively to address the industry's concerns in this area, as detailed in the Producer Licensing Assessment Report. The 2002 Report discussed the reciprocity implications of the requirement to file proof of Secretary of State registration, concluding such requirements were not inconsistent with reciprocity.

With respect to requirements pertaining to organizational documents required by the insurance regulator independent of Secretary of State registration requirements, the Working Group believes that documentation of a business entity's organizational structure outside of information provided on the NAIC's Uniform Application for Business Entity Insurance Producer Licensing/Registration is an additional submission requirement. An organizational documentation requirement for non-resident entities appears to be aimed at facilitating communication by providing director and officer contact information to the insurance regulator. This is an administrative aid rather than a consumer protection measure, particularly because the applicant's resident state may collect the same information and corporate information is readily available in most, if not all, states through the Secretary of State or equivalent Web site. The requirement also appears to be imposed by administrative practice rather than statute or regulation.

It does not appear that the savings clause of 15 U.S.C. § 6751(f) is available to protect this practice. The savings clause only protects state requirements that are consistent with the GLBA reciprocity framework. As discussed above, this practice is not consistent with the reciprocity requirement limiting the documentation that may accompany non-resident producer license applications; therefore, the practice cannot be preserved pursuant to the savings clause. The Working Group believes that

requiring a non-resident business entity to submit articles of incorporation is inconsistent with GLBA reciprocity requirements.

E. Requirements to Obtain Additional Licenses or Qualifications

1. Requiring an Underlying Life License Prior to the Issuance of a Non-Resident Variable Life License

The Working Group believes that requiring an underlying life license prior to the issuance of a non-resident variable life license is inconsistent with GLBA reciprocity requirements.

Variable life is a separate line of authority under Section 7A(5) of PLMA. Unlike other major lines of authority, most states do not have a separate insurance examination for variable life, and applicants must take a life insurance examination in order to be licensed to sell variable life insurance. As a result, states often require resident applicants to hold both a variable life and life producer license. Because the same examination qualifies applicants for both lines of authority, the common assumption is that applicants seek to obtain both licenses provided other qualifications are met. GLBA reciprocity concerns are raised when a state requires a non-resident variable life applicant to obtain qualifications for a life license or to submit proof of a valid life license, because this appears to be an additional requirement under 15 U.S.C. § 6751(c). Accordingly, the Working Group believes it would be inconsistent with reciprocity to require a producer to obtain a life license in order to sell variable life insurance in a non-resident state.

2. Requiring Individuals Seeking a Fraternal Non-Resident License to Have a Fraternal Certificate from a Company

The Working Group believes that requiring a non-resident applicant to submit a fraternal certificate is inconsistent with GLBA reciprocity requirements.

On its face, a fraternal certificate requirement for non-resident applicants is inconsistent with the GLBA reciprocity framework. It is documentation required to be submitted in addition to the permitted request for licensure, application, proof of licensure in good standing and applicable fee. It does not appear that the savings clause of 15 U.S.C. § 6751(f) is available to protect this practice because it creates an additional submission requirement inconsistent with the GLBA reciprocity framework. States with this requirement should consider whether the requirement can be waived as to non-resident applicants under Section 16A of the PLMA. The Working Group believes that requiring a non-resident applicant to submit a fraternal certificate is inconsistent with GLBA reciprocity requirements.

F. States Not Adopting the Major Lines of Authority Definitions of the PLMA

GLBA does not impose any requirement that states adopt uniform line of authority definitions. The specific requirement concerning the scope of license authority is that states “permit a producer that has a resident license for selling or soliciting the purchase of insurance in its home state to receive a license to sell or solicit the purchase of insurance [in other reciprocal states] as a nonresident *to the same extent* that such producer is permitted to sell or solicit the purchase of insurance in its State.” 15 U.S.C. § 6751(c)(1) (emphasis added). Therefore, GLBA requires not definitional uniformity but that non-resident producer have the ability to sell or solicit “to the same extent” as permitted in the home state. Presumably, states have the flexibility to determine how to provide “to the same extent” authority to non-residents. Through the PLWG, states have established the goal of consistent scopes of authority by developing uniform definitions.

The Working Group believes uniform adoption of line of authority (LOA) definitions in Section 7A of the PLMA is the preferred approach to LOA consistency. In fact, it is important to note that adoption of the PLMA definitions of major LOAs, as well as definitions of the core limited LOAs, is part of the Uniform Resident Licensing standards. A state’s compliance status with any specific resident licensing uniform standard, however, does not necessarily translate into a reciprocity issue. Non-resident licensing reciprocity can be affected by how a state implements the uniform standards.

Inconsistent LOA definitions from state to state could possibly implicate the anti-discrimination element of GLBA reciprocity: whether any requirement is imposed upon any otherwise qualified non-resident producer that has the effect of limiting or conditioning the producer’s activities because of the producer’s residence or place of operations. If a difference in scope of authority between two states results in a producer being required to satisfy additional conditions in a non-resident state beyond those permitted under the GLBA reciprocity framework, then the LOA definitions, as applied in practice, may result in a barrier to entry based on the producer’s residence or place of operations.

The Working Group is not aware of specific examples of how LOA definitions have created, in practice, an obstacle to non-resident licensing. While a lack of definitional uniformity can lead to some difficulty in administering and tracking the qualifications of producers, the Working Group does not believe that inconvenience necessarily translates into a violation of reciprocity. To be sure, the potential exists for non-compliance with reciprocity. To avoid such a result, the Working Group urges states to enact the LOA definitions in Section 7A of the PLMA. For states that have not done so, the Working Group encourages such states to maintain department procedures to ensure non-residents can, in fact, sell or solicit “to the same extent” as permitted in the home state. The state assessment reviews indicate that practices are in place to accommodate minor wording differences in LOA definitions. Likewise, the PLWG has devoted considerable time to mapping and coordinating state LOAs to avoid any difficulties in practical application. These efforts have been carried through to NIPR business rules, which also serve to minimize LOA differences. Accordingly, the Working Group does not believe that lack of LOA definitional uniformity, standing alone, necessarily translates into inconsistency with GLBA reciprocity.

G. Verifying Legal Work Authorization for Non-U.S. Citizens Non-Resident Applicants

The Working Group believes that verifying the legal work authorization for non-resident applicants who are non-U.S. citizens is not inconsistent with GLBA reciprocity requirements.

The NAIC Legal Division previously noted that several states that may require non-resident producer license applicants to provide evidence of a legal work authorization if the non-resident applicant is not a citizen of the U.S. Most states implemented this practice because of the federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (the “Welfare Reform Act”), 8 U.S.C. § 1601 et seq., which restricts the eligibility of non-U.S. citizens to receive state and local benefits. Specifically, Section 1621(c)(1)(A) provides that state or local public benefits are broadly defined to include any “professional license . . . provided by an agency of a State or local government.” This has been generally interpreted to include insurance producer licenses.

The Welfare Reform Act does not address the issue of resident and non-resident license applicants, but simply requires the states to verify work status prior to issuing a license. While some have argued that checking a non-resident producer application for verification of legal work authority would be an “additional requirement” under GLBA, the Welfare Reform Act directs states to carry out this requirement. The rules of statutory construction provide that an implied repeal will only be found where the provisions in the two statutes are in irreconcilable conflict. In the absence of specific authority providing that GLBA is in conflict with the Welfare Reform Act, it may be inappropriate for the non-resident state insurance regulator to delegate this responsibility to the non-resident applicant’s state of residence. Therefore, the Working Group believes that verifying the legal work authorization for non-resident applicants who are non-U.S. citizens is not inconsistent with GLBA reciprocity requirements.

H. Enforcing/Verifying Minimum Age Requirements for Non-Resident Applicants

The Working Group believes that it is not inconsistent with GLBA reciprocity requirements for states to enforce minimum age requirements for non-resident applicants; however, the Working Group believes it is inconsistent with GLBA reciprocity for states to verify the age of a non-resident applicant through the submission of additional documentation.

The 2002 Report found that minimum requirements respecting the age of contracting parties in an insurance transaction do not contravene the spirit or letter of producer licensing reciprocity: “Minimum age requirements are grounded in state contract law, which allows minors to contract in very limited circumstances.” Age requirements can therefore be characterized as consumer protection laws, which are specifically mentioned under the savings provisions of 15 U.S.C. § 6751(f). Therefore, a state can enforce a minimum age requirement as to a non-resident applicant who is properly licensed and of minimum age in the applicant’s home state. For example, a state with a minimum age of 21 may decline to issue a license to a non-resident applicant who is 19 years old, even though the applicant is properly licensed in a home state where the minimum age is 18.

The question of “verifying,” as opposed to enforcing, minimum age requirements is different. The distinction hinges on whether a state requires the submission of documentation establishing an applicant’s legal age in addition to the date of birth collected on the uniform application. As stated previously, 15 U.S.C. § 6751(c) limits the submission requirements that may be imposed upon non-resident applicants. The savings clause of 15 U.S.C. § 6751(f) would not necessarily operate to protect a state requirement inconsistent with these four permitted steps. Therefore, if a state can confirm from either the application or by other means independent of an additional submission from the applicant that an applicant does not meet the state’s

minimum age requirement, it may deny the issuance of a license. Accordingly, the Working Group believes it is inconsistent with GLBA reciprocity requirements to require the submission of additional documentation to verify a non-resident applicant's age.

I. Requiring Non-Resident Producers to Renew Licensure Annually, while Resident Producers Renew Biennially

The Working Group believes that offering inconsistent terms of licensure for residents and non-residents is inconsistent with GLBA reciprocity requirements.

This requirement does not call for any specific additional submission on the part of the producer, nor is the term of licensure a specified element of the GLBA reciprocity framework. This requirement implicates the third element of GLBA's reciprocity conditions: whether any requirement is imposed upon any otherwise qualified non-resident producer that has the effect of limiting or conditioning the producer's activities because of the producer's residence or place of operations. This element is traditionally cited as prohibiting residency limitations on the placement of certain business, such as state-funded projects or statutory funds. However, the effect of the requirement at issue limits the duration of a producer's license because of the producer's place of residence. This would seem to conflict with the anti-discrimination element of the GLBA reciprocity framework, even though no extra documentation is required to be presented with the renewal/continuation application.

It does not appear that the savings clause of 15 U.S.C. § 6751(f) is available to protect this practice because the basis for the practice appears to be inconsistent with the reciprocity framework even if there is consumer protection or other regulatory value inherent to this requirement. Therefore, the Working Group believes that offering inconsistent terms of licensure for residents and non-residents is inconsistent with GLBA reciprocity requirements.

J. Trust Accounts

The Working Group believes it is inconsistent with reciprocity to impose trust account requirements during the licensing process or in a discriminatory manner against non-residents, but does not believe trust account requirements of general application are necessarily inconsistent with reciprocity. The Working Group considered whether specific trust account requirements identified by the Independent Insurance Agents and Brokers of America (IIABA), as applied to non-resident producers, are inconsistent with GLBA reciprocity requirements. In written comments, the IIABA urged further consideration of whether these requirements are consistent with reciprocity: (1) obligating non-resident producers to maintain trust accounts in a financial institution with an office in the non-resident state; and (2) obligating non-resident producers to maintain funds related to business generated within the non-resident state in a separate state-specific trust account. The Producer Licensing Assessment Report and the individual state reports, including the underlying documentation, do not indicate that these requirements exist in any jurisdiction. Anecdotal information indicates that such requirements are not enforced as a prerequisite to licensure or through a licensure action.

The 2002 Report included a brief discussion of trust account requirements, but the Report did not specifically address the requirements raised by IIABA. The 2002 Report indirectly indicated that a requirement as to where a trust account should be maintained could have some bearing on GLBA reciprocity. Hypothetically, the requirements raised by IIABA could be inconsistent with GLBA reciprocity if implemented in a way that establishes submission requirements beyond those permitted by GLBA; e.g., the non-resident producer applicant might be required to submit proof of access to an account at a financial institution with an office in the non-resident state. It does not appear the savings clause of 15 U.S.C. § 6751(f) would protect such practices. Therefore, if trust account requirements specific to non-residents are imposed as a condition to licensure, the Working Group believes such requirements would be inconsistent with reciprocity.

The Working Group, however, does not believe trust account requirements imposed upon non-residents are inconsistent with reciprocity as a general rule. If a state imposes on all producers the general requirement to maintain a trust account, the Working Group believes such requirements would not implicate GLBA reciprocity unless they "limit or condition" the producer's activities because of the producer's residence or place of operation. Thus, the Working Group believes it is permissible for a state to require a non-resident producer to maintain a trust account somewhere as a general regulatory requirement unrelated to licensing, but we do not believe it would be consistent with reciprocity to require non-resident producers to maintain specific trust accounts in the non-resident state.

To the extent states impose trust account requirements as a condition to licensure or otherwise limit or condition the non-resident producer's activities because of residence or place of operations, we encourage states to consider utilizing waiver authority or modifying statutory application to ensure general trust account requirements are applied in a manner consistent with reciprocity.

K. Verifying an Applicant for a Non-Resident License Renewal Has Paid All Undisputed Taxes and Unemployment Insurance Contributions

The Working Group believes that a tax verification requirement applicable to non-residents and implemented in such a way that it does not depend on additional documentation supplied by the applicant is saved under 15 U.S.C. § 6751(f), because it is not inconsistent with GLBA reciprocity requirements.

States' tax clearance practices have been part of the reciprocity analysis since the 2002 Report but a detailed analysis has not been published. State consideration or verification of information derived from sources other than the applicant does not trigger the additional submission requirement element of the GLBA reciprocity framework. While GLBA limits the types of documentation a reciprocal state can require a non-resident applicant to submit, it does not address the information a state may consider or verify through sources other than the applicant.

This reasoning holds true for tax clearance as implemented in certain states as well as many other conditions of licensure such as the possible grounds for license denial, nonrenewal or revocation included in Section 12 of the PLMA. The background questions section of the NAIC Uniform Applications solicits a "yes" or "no" response on most questions and, with regard to tax clearance, asks for the applicable jurisdiction where a delinquency action exists. Thus, the implementation of a tax clearance requirement that does not require submission of proof by the applicant is not inconsistent with GLBA reciprocity. GLBA serves to limit the applicant's documentation responsibilities and discriminatory state requirement practices as applied to non-residents; it does not serve to limit the information a state may consider in issuing or renewing a license.

Accordingly, the Working Group does not believe that a tax verification requirement applicable to non-residents and implemented in such a way that it does not depend on additional documentation supplied by the applicant is inconsistent with GLBA reciprocity requirements.

L. One-Time Training and Continuing Education Requirements

The Working Group believes that continuing education requirements based on federal mandates are not inconsistent with GLBA reciprocity requirements.

The issue is whether it is permissible to obligate non-residents to complete continuing education on a particular subject matter or product in order to obtain or renew a license to sell, solicit or negotiate insurance policies involving the specific subject matter or product. States regularly count specialized subject-matter training toward the total continuing education requirements applicable to resident producers. Assuming a producer maintains the same scope of licensure in both resident and non-resident jurisdictions, the potential reciprocity issue arises if the producer is forced to satisfy continuing education requirements in a non-resident state irrespective of the training completed in the producer's resident state. In 15 U.S.C. § 6751(c)(2), GLBA specifically provides that a reciprocal state must accept a non-resident producer's satisfaction of the home state's continuing education requirements as satisfying the non-resident state's own continuing education requirements.

Continuing education requirements specific to crop insurance and long term care partnership, as well as flood insurance, derive from federal mandates. Similar to the above analysis of the practice of verifying legal work authorization for non-resident applicants in accordance with a federal mandate, in the absence of any federal directive to the contrary, it appears that the specialized continuing education requirements described above must stand regardless of any perceived conflict with the GLBA continuing education element. The federally-mandated training described above is imposed by the federal government rather than the non-resident state, which arguably removes the training from the reciprocity analysis.

Further, some of the federal mandates were enacted post-GLBA: the flood insurance training requirement in 2004 and the long-term care training requirement in 2005. The canon of statutory construction known as *in pari materia* calls for statutes on the same general subject to be interpreted in harmony with each other whenever possible. The enactment of specific subject-matter training requirements subsequent to the continuing education reciprocity element of GLBA may be read to

mean that Congress' intent was to apply the training requirements despite the potential conflict with producer licensing reciprocity.

Therefore, the Working Group does not believe that continuing education requirements based on federal mandates are inconsistent with GLBA reciprocity requirements.

M. Viatical Settlements

The following is re-produced, in substantial part, from the 2002 Report:

Two comment letters were received from an interested party dealing with the issue of whether reciprocal treatment should be afforded viatical settlement brokers. The interested party contended that those states requiring separate licensing for viatical settlement activities could not be considered reciprocal. Because GLBA includes a broad definition of "insurance producer" in 15 U.S.C. § 6766, the interested party argued that the term included persons who advise or facilitate viatical or life settlements, which would thus embrace viatical settlement brokers. Characterizing GLBA as envisioning licensing reciprocity or uniformity for this broad range of "insurance producers," the interested party concluded that states requiring separate viatical settlement licensure are not reciprocal. Additionally, during the Working Group's meeting on June 10, 2002, a representative of the interested party commented that he did not advocate reciprocity for viatical settlement brokers. Rather, it was argued that states failed to achieve reciprocity where producers may perform certain services in some states but require separate licensing to do so in others.

For purposes of the Working Group's task, this issue *is* one of reciprocity. The NAIC Legal Division previously examined the question of which insurance producers were entitled to reciprocity under GLBA. In May 2000, in response to requests from several state insurance regulators, the Legal Division issued a memorandum on this topic. The memorandum noted GLBA's broad definition of "insurance producer," but reviewed particularly the provisions requiring producer licensing reciprocity. The standards for achieving reciprocity provided in 15 U.S.C. § 6751(a) and (c) refer only to producers that sell or solicit the purchase of insurance. Therefore, GLBA only requires that reciprocity be extended to those classes of producers that sell or solicit insurance. Because they do not sell or solicit the purchase of insurance, viatical settlement brokers are not entitled to reciprocity regardless of the broad definition of "insurance producer."

Thus, the Working Group rejected the argument that GLBA entitles viatical settlement brokers to reciprocity in non-resident producer licensing or otherwise requires states to eliminate requirements that those who engage in viatical settlement activities be separately licensed to do so.

N. Limited Lines Issues

Consumer Credit Industry Association (CCIA) and World Access urged for special reciprocity and uniformity treatment for limited lines that are very narrow in scope and resemble service contracts. These issues have been referred to the PLWG for consideration. Because we are not presented with any specific reciprocity-related issues, the NARAB Working Group offers no specific comments on whether certain limited lines should be subject to special treatment. The Working Group notes that GLBA reciprocity applies to limited lines as well as major lines, but we will leave the present issues with the PLWG for consideration.

NEXT STEPS

GLBA appears to assume some process exists for measuring continuing compliance by states with the reciprocity mandates of 15 U.S.C. § 6751(c). Without mandating a particular process, 15 U.S.C. § 6751(e) states, in relevant part, that "[i]f, at any time, the . . . reciprocity required by subsection[] . . . (c) of this section no longer exists, the provisions of this subchapter shall take effect 2 years after the date on which such . . . reciprocity ceases to exist, unless the . . . reciprocity required by those provisions is satisfied before the expiration of that 2-year period." The NARAB Working Group understands this provision to mean that, upon a determination by the NAIC that the required level of reciprocity among states no longer exists, the states would have two years to come back into compliance. If the states failed to do so, the NARAB entity would be established as set out in 15 U.S.C. §§ 6752-6765.

In adopting this updated reciprocity standard, the NARAB Working Group makes no specific finding about any individual state's continuing compliance with GLBA reciprocity requirements. If this updated standard is accepted by the Executive Committee and Plenary, the Working Group will initiate a process for re-evaluating all states for reciprocity compliance,

likely incorporating some form of checklist and self-certification as was done with the 2002 Report. Our re-evaluation of state compliance is not intended to raise any issues or concerns about certification of states based on the standards of the 2002 Report. This report is intended to supplement, rather than supersede, the conclusions of the 2002 Report. Because of the state producer licensing assessments and the consideration of additional issues not raised in 2002, more information is available to the Working Group. We intend to utilize this information to implement a reciprocity framework that reinforces and strengthens producer licensing reciprocity.

The Working Group recognizes that some states may need to seek legislative or administrative changes in order to meet an updated reciprocity standard. Additionally, states may wish to evaluate whether continuing compliance may be achieved through waiver or other insurance department action. The Working Group is committed to working with NAIC members and individual states in developing, by the 2009 Fall National Meeting, a detailed process for carrying out a formal reassessment of producer licensing reciprocity under the updated reciprocity standard described in this report.

**Report of the
Life Insurance and Annuities (A) Committee**

The Life Insurance and Annuities (A) Committee met Nov. 4, 2011. During this meeting, the Committee:

1. Heard a legislative update of federal bills of interest to the Committee.
2. Discussed and adopted its 2012 Proposed Charges.
3. Continued its discussions of issues related to contingent annuities. The Committee decided to form a subgroup to review the issues identified in the Life Actuarial (A) Task Force referral related to contingent annuities and report the results of its review to the Committee.
4. Adopted the report of the Life Actuarial (A) Task Force, which did not include adopting the Task Force's statement on Actuarial Guideline XXXVIII. The Committee received the Task Force's statement on Actuarial Guideline XXXVIII and forwarded it to the new joint working group composed of members of the Life Insurance and Annuities (A) Committee and Financial Condition (E) Committee, which was established by the Executive (EX) Committee to address issues surrounding the statutory reserve requirements for insurers offering universal life secondary guarantee (ULSG) products.

**Report of
Health Insurance and Managed Care (B) Committee**

The Health Insurance and Managed Care (B) Committee met Nov. 4, 2011. During this meeting, the Committee:

1. Heard a legislative update on federal bills of interest to the Committee.
2. Heard a briefing on the Institute of Medicine report titled “Essential Benefits – Balancing Coverage and Cost.”
3. Adopted its 2012 Proposed Charges.
4. Adopted the Consumer Information (B) Subgroup report.
5. Adopted the Exchanges (B) Subgroup report.
6. Adopted the Medical Loss Ratio Quality Improvement Activities (B) Subgroup report.
7. Adopted the joint Limited Medical Benefit Plan (B/D) Working Group report.
8. Adopted the Health Actuarial (B) Task Force report.
9. Adopted the Regulatory Framework (B) Task Force report, which included adopting its 2012 Proposed Charges and the revisions to the *Utilization Review and Benefit Determination Model Act* (#73) and the *Health Carrier Grievance Procedure Model Act* (#72).
10. Adopted the Senior Issues (B) Task Force report, which included adopting the Medigap PPACA (B) Subgroup’s *Medicare Supplement Insurance First Dollar Coverage and Cost Shares Discussion Paper*.

**Report of the
PROPERTY AND CASUALTY INSURANCE (C) COMMITTEE**

The Property and Casualty Insurance (C) Committee met Nov. 5, 2011. During this meeting, the Committee:

1. Heard a presentation from Howard C. Kunreuther (Author—*At War with the Weather*; Professor—the Wharton School) on modifying the National Flood Insurance Program by offering multi-year policies tied to the property, rather than the property owner.
2. Heard a presentation from Bryon Ehrhart (Aon Benfield) on the use of blended catastrophe models and their impact on insurer pricing and capital requirements.
3. Adopted amendments to the *Model Risk Retention Act* (#705).
4. Heard an update from the Council of Insurance Agents & Brokers (CIAB) on progress toward implementing the Lexis/Nexis Insurance Exchange.
5. Discussed federal efforts to reauthorize the National Flood Insurance Program.
6. Adopted its 2012 Proposed Charges.
7. Adopted its task force and working group reports: Casualty Actuarial and Statistical (C) Task Force; Surplus Lines (C) Task Force; Title Insurance (C) Task Force; Workers' Compensation (C) Task Force; Advisory Organization Examination Oversight (C) Working Group; Catastrophe Insurance (C) Working Group; Risk Retention (C) Working Group; and Transparency and Readability of Consumer Information (C) Working Group.

Adopted by the Property and Casualty Insurance (C) Committee – Sept. 16, 2011

The Background and Implications of Defective Drywall

NAIC Catastrophe Insurance (C) Working Group

August 31, 2011

The Background and Implications of Defective Drywall

Introduction

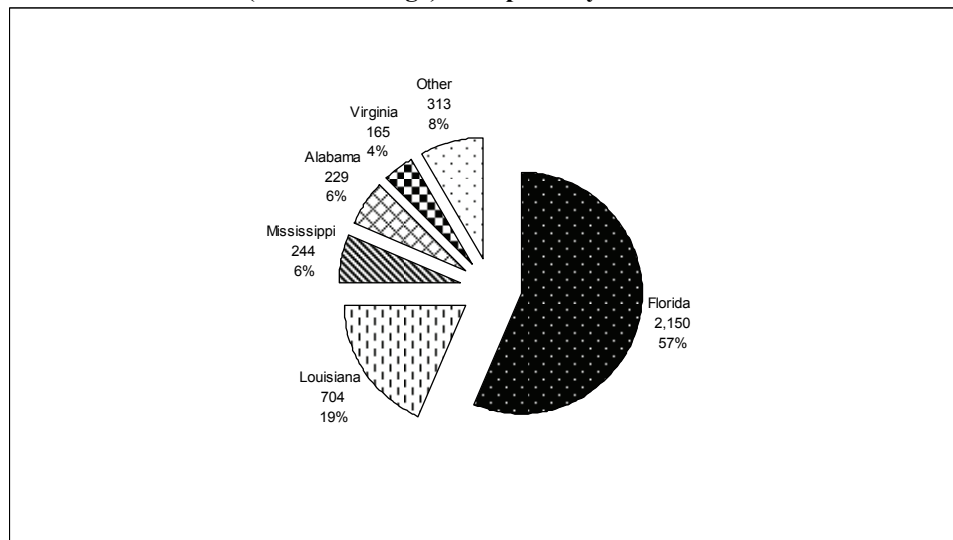
At the request of the Catastrophe Insurance (C) Working Group, NAIC staff has prepared the following white paper addressing the issues surrounding the defective drywall that was imported from China between 2004 and 2008. This paper will provide a background of the defective drywall problem, including the latest information from the Consumer Product Safety Commission (CPSC). It will explore the reported effects, theories of liability, insurance coverage issues under general liability and property insurance policies, potential remedies, and recent litigation.

Overview

The housing boom and the extensive damage to homes and buildings by the unusual number of hurricanes¹ that struck the United States between 2004 and 2008, led to a drywall shortage in the United States. Therefore, drywall was imported into the United States from other sources, including China. Complaints regarding defective drywall began to emerge in the summer of 2008. The initial complaints came primarily from individuals living in and around the southern region of Florida. The problems with the defective drywall include the smell of rotten eggs; failure of air conditioning equipment; and corrosion of pipes, wiring, furniture, fixtures and jewelry. It also should be noted that the corrosion of electrical wiring can hamper the effectiveness of smoke detection and can create a risk of fire.² Health problems—including irritated eyes and skin, asthma attacks, sinus infections, bloody noses, headaches and persistent cough—also have been alleged.³

As of March 2011, the latest count from the CPSC consists of 3,820 complaints in 42 states, the District of Columbia, American Samoa and Puerto Rico. A majority of the reports are from five states: Florida (57%), Louisiana (19%), Mississippi (6%), Alabama (6%) and Virginia (4%). The following figure offers a graphical representation.⁴

Number (and Percentage) of Reports by State



Samples of the alleged defective drywall were tested by the CPSC. The manufacturers of the top 10 drywall samples containing the highest emissions of hydrogen sulfide included Knauf Plasterboard (Tianjin) Co. Ltd.: (year of manufacture 2005) China; Taian Taishan Plasterboard Co. Ltd.: (2006) China; Shandong Taihe Dongxin Co.: (2005) China; Shandong Chenxiang GBM Co. Ltd. (C&K Gypsum Board): (2006) China; and Beijing New Building Materials (BNBM): (2009) China.⁵

Other Chinese-manufactured drywall samples tested contained either low or no detectable emissions of hydrogen sulfide. Domestically manufactured drywall samples tested also contained either low or no detectable emissions of hydrogen sulfide.⁶

¹ These include Hurricane Ivan (2004), Hurricane Katrina (2005) and Hurricane Rita (2005).

² <http://www.cpsc.gov/info/drywall/faqs.html>.

³ http://www.cdc.gov/nceh/drywall/docs/Drywall_for_Healthcare_Providers.pdf.

⁴ <http://www.cpsc.gov/info/drywall/where.html>.

⁵ <http://www.cpsc.gov/cpsc/pub/prerel/prhtml10/10243.html>.

⁶ *Ibid.*

The CPSC also released the results of the drywall emissions tests by Lawrence Berkeley National Laboratories (LBNL) in April 2010. These tests indicated the patterns of reactive sulfur compounds emitted from drywall samples show a clear distinction between certain Chinese-manufactured drywall samples manufactured in 2005/2006 and other Chinese-manufactured and non-Chinese manufactured drywall samples.⁷

Interim Guidance

In January 2010, the CPSC issued a joint news release with the U.S. Department of Housing and Urban Development (HUD) concerning interim guidance on the subject of the identification of homes with the corrosive defective drywall. The interim guidance was updated March 18, 2011. The updated guidance provides information regarding the visual signs of metal corrosion, evidence of drywall installation in the relevant time period and the identification of other substantial evidence or characteristics. The visual inspection must show: blackening of copper electrical wiring and/or air conditioning evaporation coils; and the drywall installation (for new construction or renovations) must have taken place between 2001 and 2009. A positive result for the first step (including both criteria) is a prerequisite to any further consideration. Given the fact corrosion of metal in homes can occur for other reasons, it is important to provide corroborating evidence of problem drywall. Homes with the characteristic metal corrosion problems must also have at least two of these corroborating conditions if the new drywall was installed between 2005 and 2009. For installations between 2001 and 2004, at least four of the following conditions must be met: elemental sulfur levels in samples of drywall core found in the home exceeding 10 ppm;⁸ corrosive conditions in the home, demonstrated by the formation of copper sulfide on copper coupons (test strips of metal) placed in the home for a period of two weeks to 30 days or confirmation of the presence of sulfur in the blackening of the grounding wires and/or air conditioning coils; confirmed markings of Chinese⁹ origin for drywall in the home; elevated levels of hydrogen sulfide, carbonyl sulfide, and/or carbon disulfide emitted from samples of drywall from the home when placed in test chambers using ASTM Standard Test Method D5504-08 or similar chamber or headspace testing; and corrosion of copper metal to form copper sulfide when copper is placed in test chambers with drywall samples taken from the home. Collecting evidence of these corroborating conditions, in some cases, will require professional assessors and/or testing by analytical laboratories.¹⁰

The updated remediation guidance regarding the defective drywall recommends replacement of all possible problematic drywall; fire safety alarm devices (including smoke alarms and carbon monoxide alarms); electrical distribution components (including receptacles, switches and circuit breakers); and gas service piping and fire suppression sprinkler systems. The guidance states all testing and remediation work should be conducted in compliance with applicable building codes, occupational safety and health standards, and environmental regulations.¹¹

Initial studies by the Federal Interagency Task Force on Problem Drywall found an association between the presence of problem drywall and corrosion of metal in homes. Should additional scientific information become available suggesting that less extensive or costly remediation methods would work, CPSC staff and HUD staff will consider the evidence and provide protocol updates as appropriate.¹² The investigation regarding defective drywall has been the largest compliance investigation in CPSC's history. To date, the agency has spent more than \$5 million to investigate the chemical nature and the chain of commerce of problem drywall, and issue the associated identification and remediation guidance to assist impacted homeowners.¹³

⁷ <http://www.cpsc.gov/info/drywall/LBNLsulfur.pdf>.

⁸ Note that a preliminary screening for strontium levels exceeding 1,200 ppm may be used to identify boards to test for elemental sulfur. The Task Force emphasizes, however, that such preliminary screening for strontium does not necessarily indicate the presence of problem drywall, rather, only that additional testing in these areas may be advised.

⁹ This does not imply that all Chinese drywall or that only Chinese drywall is associated with these problems, but among homes with the characteristic corrosion, Chinese drywall is a corroborating marker for the characteristic problems.

¹⁰ <http://www.cpsc.gov/info/drywall/IDguidance031811.pdf>.

¹¹ <http://www.cpsc.gov/info/drywall/Remediation031811.pdf>.

¹² *Ibid.*

¹³ <http://www.cpsc.gov/cpsc/pub/prerel/prhtml10/10243.html>.

Alleged Effects

Bodily Injury Exposure (Health Issues)

According to a bulletin issued by the U.S. Centers for Disease Control and Prevention (CDC), there have been very few studies of the effects of exposure to low levels (1-100 ppb) of sulfur gases for long periods of time. However, the CDC reported prolonged exposure to the compounds found in the drywall, namely carbonyl sulfide and carbon disulfide, may result in eye, nose and throat irritation, as well as exacerbation of respiratory problems. Less is known about chronic exposure to lower levels (1–30 ppb), such as those found in the limited indoor testing conducted in homes reported to contain the defective drywall.¹⁴ The CDC reports that short-term exposure to low concentrations of sulfur gas may result in symptoms such as eye irritation, sore throat, stuffy nose/rhinitis, cough, shortness of breath/chest pain, nausea and headaches. Chronic exposure to the low concentrations may also cause the additional symptoms of fatigue, loss of appetite, irritability and poor memory.¹⁵

Property Damage

The types of property damage that have been reported from the defective drywall exposure include damage to: air conditioning equipment; corrosion of pipes, wiring, furniture and jewelry; electrical motors in appliances and HVAC systems; and intermittent problems with appliances.¹⁶

Theories of Liability

General theories of liability that have been alleged to date against defendants in drywall litigation include, but are not limited to, negligence; strict products liability; breach of warranty; fraudulent concealment and misrepresentation; private nuisance; breach of contract; and violations of deceptive and unfair trade practices acts (for example, the Florida Deceptive and Unfair Trade Practices Act, Florida Statute, Section 501.201).¹⁷ The liability and theory asserted will vary depending on the contractual relationship (or lack thereof) between the homeowner and the particular defendant as well as the type of injury allegedly sustained. In cases where the defendant is in direct contract with the homeowner, that defendant might potentially face liability on all of the legal theories listed.

Negligence

By definition, negligence also may include an unreasonable failure to exercise the care and caution that a fair and prudent person would exercise. It also includes the failure to prevent harm or the actual doing of harm. The definition of negligence varies by jurisdiction but is generally thought of as the failure to exercise the care and caution that a prudent person would exercise to prevent reasonably foreseeable harm. The theories of negligence that have been advanced in connection with problem drywall include allowing drywall to be exposed to moisture or humidity while shipping; drywall being exposed to moisture between the shipper and the trucker; the contractor leaving the drywall outdoors to be exposed to moisture; and the builder installing the drywall without the home being properly sealed, thus exposing the drywall to moisture.

Product Liability

Product liability is the legal responsibility of the manufacturer, distributor, installer or retailer, to the user or consumer of a product. It is important to note that product liability laws vary from state to state.¹⁸ The liability arises out of the manufacture, distribution or sale of an unsafe, dangerous or defective product and the failure of the manufacturer, distributor or retailer to meet the legal duties imposed with respect to the particular product (in this case, defective drywall). To collect damages in a negligence action, the plaintiff must prove that the manufacturer, distributor or retailer was not reasonably prudent in the design, manufacture, distribution or sale of the article that caused the injury.¹⁹

¹⁴ www.cdc.gov/nceh/drywall/docs/Drywall_for_Healthcare_Providers.pdf.

¹⁵ *Ibid.*

¹⁶ <http://www.cpsc.gov/info/drywall/how.html>.

¹⁷ www.casact.org/education/spring/2010/handouts/C7-Karlinsky.pdf.

¹⁹ *Commercial Liability Risk Management and Insurance, 2nd Edition.*

Strict Liability

Many product liability lawsuits are now based on strict liability, which is liability that is not based on negligence or intent to cause harm. In the case of the defective drywall, strict liability is of particular concern because the seller can be any party in the chain of distribution from the manufacturer to the retailer. In this case, there is no need to prove negligence. Although it varies by jurisdiction, in an action alleging strict liability in tort, the plaintiff generally must prove all three of the following elements: 1) the product was defective when it left the manufacturer's or supplier's custody or control; 2) the defective condition made the product unreasonably dangerous; and 3) the defective product was the proximate cause of the plaintiff's injury. Although products liability actions based on strict liability in tort are typically directed at the manufacturer of the product, the plaintiff may seek damages from any entity that qualifies as a seller, including a distributor or retailer.²⁰

Fraudulent Concealment and Misrepresentation

In the case of the defective drywall, if the builder or manufacturer had knowledge that there were problems with the defective drywall and chose to install it anyway without disclosing to the buyer that problems exist, fraudulent concealment and misrepresentation might apply.

Private Nuisance

Nuisance law varies from jurisdiction to jurisdiction. It is typically defined to be the unreasonable interferences with another person's use or enjoyment of property. Nuisance can be classified as either private or public.²¹ In the case of the defective drywall, private nuisance might be applied based on the argument that the defective drywall causes unreasonable interference with the person's use or enjoyment of his or her home.

Breach of Contract

Breach of contract is the failure to comply with the terms or conditions incorporated in a contract. In the case of the defective drywall, the contract might be between a buyer and a builder; a builder and a developer, etc.

Breach of Warranty

Breach of warranty is most often associated with a failure to warn consumers about the inherent dangers of a product or use of the product. There are three typical categories for breach of warranty: 1) breach of express warranty; 2) breach of implied warranty of merchantability; and 3) breach of implied warranty of fitness for a particular purpose.²²

Breach of express warranty signifies that the manufacturer violated their own written guarantee, while breach of implied warranty means the defective product was reasonably understood to be free from defect and no disclaimers such as "as is" or "with faults" indicated otherwise. Breach of implied warranty of fitness for a particular purpose means the seller knew the buyer's purpose and the buyer was relying on the seller's skill and judgment to fulfill that purpose.²³

Claims relating to breaches of express warranties contained in the original construction contract will be relatively straightforward to the extent the warranties are still in effect at the time the claim is made. Where a homebuilder builds a home for a developer or other owner who then subsequently sells the home to the eventual claimant, the warranties contained in the original contract for construction would pass to the subsequent purchaser and would provide an avenue of recovery for the homeowner. These warranties are typically measured from the date that the construction is completed (issuance of a Certificate of Occupancy), unless the language of the provision denotes a different trigger.

Many states have a New Home Warranty Act, which mandates that a contractor warrants its work to the homeowner for a certain period of time. There are many ramifications of the act applying to the defective drywall.²⁴ The warranty period is "preemptive," meaning that the warranty periods start at a certain time (delivery of the home) and end at a certain time, and is not suspended because the homeowner was without knowledge of the defect. The homeowner is required to give the builder written notice, by registered or certified mail, of the defect and give the builder a reasonable opportunity to comply with the provisions of the act. The act may completely exclude or significantly limit claims for health damages caused by the defects.²⁵

²⁰ *Commercial Liability Risk Management and Insurance, 2nd Edition.*

²¹ *Commercial Liability Risk Management and Insurance, 2nd Edition.*

²² *Ibid.*

²³ *Ibid.*

²⁴ <http://defectivedrywallblog.com/tag/new-home-warranty-act>.

²⁵ *Ibid.*

Unfair Trade Practices Statutes

Unfair trade practices encompass a broad array of torts, all of which involve economic injury brought on by deceptive or wrongful conduct. The Federal Trade Commission (FTC) was established by the U.S. Congress, in part, to protect consumers from deceptive trade practices. Moreover, many states have enacted an unfair trade practice act.²⁶ In jurisdictions where it is permissible for a private individual to seek to enforce such statutes, defendants in drywall litigation may be faced with such claims.

Issues Related to Insurance Coverage

There are many insurance coverage issues that arise from allegations of defective drywall whose analysis and outcome will vary from state to state depending on governing law and from policy to policy depending on applicable policy language.

Occurrence

Generally, an “occurrence” is a prerequisite to possible coverage under a liability policy and a “direct physical loss” is a prerequisite to possible coverage under a property policy. With respect to allegedly defective drywall, there are questions as to whether there has been an occurrence, or if direct physical loss has occurred.

Trigger of Coverage

Additionally, there may be situations in which it is unclear when the claimed “occurrence” or a “direct physical loss” took place. Thus, even where there has been an “occurrence” or a “direct physical loss” there may be issues as to whether the “occurrence” or “direct physical loss” took place within the policy period. Accordingly, “trigger” of coverage—a term referring to the event that must take place during the policy period to make that particular policy even potentially applicable—may become an issue.²⁷ Depending on the facts, jurisdiction and policy language, one of the following “triggers of coverage” theories may apply: 1) exposure; 2) manifestation; 3) continuous; and 4) injury-in-fact. Under the exposure theory, property damage occurs upon installation of the defective product. Under the manifestation theory, property damage occurs at the time damage manifests itself or is discovered. The continuous trigger approach defines property damage as occurring continuously from time of installation until the time of discovery. Finally, under the injury-in-fact trigger, which is also referred to as damage-in-fact, coverage is triggered when the property damage underlying the claim actually occurs.²⁸

Exclusions

Even where there is an occurrence or direct physical loss that triggers coverage, policy exclusions may apply. Generally the insured has the initial burden to prove that a loss falls within the grant of coverage. Thereafter, the burden shifts to the insurer to establish that exclusions apply.

Commercial General Liability Policy Exclusions

The following is a discussion of several policy exclusions that might apply to claims of defective drywall but is not intended to be an exhaustive list of such exclusions nor how they might apply.

Pollution Exclusion

The pollution exclusion is contained in almost all third-party liability policies. The pollution exclusion generally bars coverage for claims for bodily injury and property damage “which would not have occurred in whole or in part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of ‘pollutants’”. Certain policies have other conditions that bear on the applicability of the pollution exclusions. Whether the pollution exclusion bars recovery in a particular case will be largely dependent upon the actual language of the exclusion at issue as well as the state law that is applied to the claim.

²⁶ According to Highbeam Research: In determining whether a practice is deceptive, Florida courts have sometimes cited to Federal Trade Commission (FTC) administrative and federal court precedent, and more recently have begun expressly to adopt at least the bare bones of the FTC's current deception standard (in effect since 1983). Florida courts cite the FTC statement, “The Commission will find deception if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer’s detriment.”

²⁷ www.thefreelibrary.com/Defective+Drywall:+Background,+Scope+And+Insurance+Coverage+...-a0212799551.

²⁸ *Commercial Liability Risk Management and Insurance, 2nd Edition*.

Fungi or Bacteria Exclusion

Most recent general liability policies contain a “fungi” or “bacteria” exclusion which generally precludes coverage for bodily injury or property damage that would not have occurred but for the exposure to or presence of fungi or bacteria (such as mold or mildew) within a building or structure, including its contents. Some plaintiffs have alleged that their drywall is defective due to the presence of such substances. To the extent that this is true, the resulting damages may be excluded. Studies are being conducted on this issue.

Damage to “Your Product” Exclusion

Many general liability policies have exclusions that apply to damage to “your product” arising out of it or any part of it. This exclusion generally applies to damage to the insured’s product itself. At a minimum, this would preclude coverage for any damage to the drywall itself. Application of this provision varies by jurisdiction and requires a fact intensive approach.

Damage to “Your Work” Exclusion

Most general liability policies have exclusions that apply to damage to “your work.” This provision bars coverage for damage to “your work”, or damages arising out of it. Again, application of this provision varies by jurisdiction and requires a fact intensive approach.

Impaired Property Exclusion

Most general liability policies have exclusions that apply to property that has not been physically injured arising out of a defect in the insured’s product or its work. As with the other exclusions, interpretation of this provision varies by jurisdiction and requires a fact intensive approach.

Recall of Products Exclusion

Most general liability policies have exclusions that apply to damage caused by products of the insured that have been recalled. To the extent that drywall claims are related to recalled products, this provision may have applicability.

Homeowners Policy Exclusions

Inherent Vice

Property policies typically exclude coverage for losses caused by inherent vice. A number of courts have defined an “inherent vice” as “any existing defects, diseases, decay or the inherent nature of the commodity which will cause it to deteriorate with a lapse of time.” In addition, “inherent vice” also has been defined “as a cause of loss not covered by the policy, does not relate to an extraneous cause but a loss entirely from internal decomposition or some quality which brings about its own injury or destruction. The vice must be inherent in the property for which recovery is sought.” While defective drywall may emit sulfur gases the off-gassing may take place without deterioration or breakdown of the drywall. Some commentators therefore have questioned whether a court would apply an “inherent vice” exclusion to bar coverage for losses due to the suspect drywall.²⁹

Latent Defect

Property policies also typically exclude coverage for losses caused by “latent defect.” “Latent defect” has been interpreted to mean a defect that is hidden, or could not have been found by routine test or examination. Courts in Louisiana³⁰ and Florida³¹ have defined “latent defect” as a defect that is hidden or concealed from knowledge as well as from sight and which a reasonably customary inspection would not reveal. The sulfur-containing materials incorporated into the defective drywall can only be detected upon destructive testing done on a sample cut out of the drywall. Therefore, it is reasonable to presume that the sulfur materials were not only hidden, but could not have been discovered by any known customary test or examination.

²⁹ www.thefreelibrary.com/Defective+Drywall:+Background,+Scope+And+Insurance+Coverage+...-a0212799551.

³⁰ See, e.g., *Nida v. State Farm Fire & Cas. Co.*, 454 So.2d 328, 335 (La. App. 3d Cir. 1984).

³¹ See, e.g., *Alexander v. Suncoast Builders, Inc.* 837 So.2d 1056 (Fla.App. 3 Dist., 2002).

Pollution or Contamination Exclusion

Property policies also usually include an exclusion directed to pollution or contamination. The exclusion generally states that the policy does not cover any loss caused by discharge, dispersal, seepage, migration, release or escape of pollutants unless the discharge, dispersal, seepage, migration, release or escape is itself caused by a peril insured against with respect to Coverage C (the personal property coverage). A “pollutant” typically is defined as any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. A “contaminant” may be defined as an impurity resulting from the mixture of or contact with a foreign substance. The definition of “waste” includes materials to be disposed of, recycled, reconditioned or reclaimed.³² According to the CPSC investigation, certain defective drywall has been found to emit sulfur reactive gases that corrode indoor metal components of a home and reportedly cause eye and throat irritations and other physical symptoms.

Faulty, Inadequate or Defective Materials Exclusion

Property policies usually do not cover losses caused by faulty, inadequate or defective “materials used in repair, construction, renovation or remodeling.” Suspect drywall is faulty, inadequate and defective in that it allegedly exudes potentially harmful (or, at least, offensive smelling) sulfur gases that damage metal components of the home, a situation neither expected nor desired by the consumer. An exclusion directed to loss caused by “faulty, inadequate or defective materials” might possibly bar coverage for the drywall, as well as the odor and corrosion attributed to the drywall.³³

Dampness or Temperature Exclusion

Property policies generally do not cover losses caused by dampness or extremes in temperature. The release of the sulfur compounds from the suspect drywall has been identified as being accelerated by heat, humidity and/or moisture. Should heat, humidity and/or moisture be recognized as the cause of the suspect drywall problems, loss or damage arising from these conditions may be excluded by a homeowners policy exclusion for loss caused by dampness or changes in temperature. An argument could be made that the exclusion applies and precludes coverage for any and all loss stemming from the action of heat and moisture.³⁴

Corrosion Exclusion

Many property policies also include an exclusion directed to loss caused by “smog, rust or other corrosion.” “Corrosion” is defined by the ASTM as “the chemical or electrochemical reaction between a material, usually a metal, and its environment that produces a deterioration of the materials and its properties.” An exclusion for damages caused by “corrosion” precludes recovery for any damage caused to property because of contact with any corrosive agent. Most jurisdictions hold that an exclusion for damages caused by corrosion precludes recovery for damages caused by corrosion regardless of what caused the corrosion or how suddenly the corrosion occurred. Thus, an exclusion for loss caused by corrosion likely bars coverage for the damage to indoor metal items attributed to defective drywall.³⁵

³² www.yrth.net/financial-news/defective-drywall-claims-may-be-covered-under-homeowners-policy-favorable-developments-in-louisiana.

³³ www.thefreelibrary.com/Defective+Drywall:+Background,+Scope+And+Insurance+Coverage+...-a0212799551.

³⁴ www.yrth.net/financial-news/defective-drywall-claims-may-be-covered-under-homeowners-policy-favorable-developments-in-louisiana.

³⁵ *11 Couch on Ins.* §153:80.

Gradual or Sudden Loss

Gradual or sudden loss is an exclusion that can be found in “all-risk” homeowners policies. The exclusion says the policy does not cover any loss caused by gradual deterioration, wet or dry rot, warping, smog, rust or other corrosion. In addition, the policy does not cover any loss caused by inherent vice, wear and tear, mechanical breakdown or latent defect. The policy might, however, insure ensuing covered loss unless another exclusion applies.

Faulty, Inadequate or Defective Planning

An “all-risk” homeowners policy may exclude loss caused by faulty, inadequate or defective: planning, zoning, development, surveying siting; design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction; materials used in repair, construction, renovation, remodeling, grading, compaction; or maintenance of part of or all of any property, whether on or off the residence. The policy might, however, insure ensuing covered loss, unless another exclusion applies.³⁶

Potential Remedies

If it can be established that the drywall in a particular home is in fact defective and has caused damage, the liability of the builders would appear likely, and in most instances, the builders will assert claims against other potentially liable parties such as manufacturers, distributors, suppliers and installers based on various theories of liability including breach of contract, breach of warranty, common law and statutory indemnity.

Similarly, each such party could assert claims against those entities above it in the stream of commerce. However, it is difficult for plaintiffs to serve foreign manufacturers in U.S. courts. In this case, the problem with the manufacturers of the defective drywall is that they are in China. The U.S. courts have no means of enforcing a judgment against a foreign company. Furthermore, an American company cannot sue again in China, because the Chinese company will claim the American company cannot re-litigate its case in China after having already fully litigated it on the merits in the United States due to *res judicata* (a doctrine prohibiting parties from trying the same case twice).³⁷ Nevertheless, given the magnitude of this problem and the likelihood that certain manufacturers may be beyond the jurisdiction of U.S. courts, or at least beyond the courts’ ability to enforce judgments, homebuilders and developers should not expect the manufacturers and suppliers to have enough assets available to satisfy all of these claims.³⁸

Litigation

Defective drywall litigation has been filed in federal and state courts (with some overlap). These actions generally name the defective drywall manufacturers, distributors, suppliers and builders as defendants.³⁹

Federal lawsuits regarding the defective drywall were filed in multiple federal districts across the United States and, therefore, fell within the purview of the Federal Rules of Civil Procedure governing Multi-District Litigation (MDL). MDL is a federal court procedure that is used to consolidate pending federal civil cases that have common questions of fact; this procedure allows one federal judge to manage pretrial procedures, discovery and motions. On June 15, 2009, the U.S. Judicial Panel on Multidistrict Litigation for the Eastern District of Louisiana initially transferred 10 defective drywall actions to the Eastern District of Louisiana under the Honorable Eldon E. Fallon. These actions included four actions from the Southern District of Florida; three actions from the Middle District of Florida; and one action each from the Northern District of Florida, Eastern District of Louisiana and Southern District of Ohio.⁴⁰ The Judicial Panel on MDL, however, has rejected attempts to transfer insurance coverage cases to the Eastern District of Louisiana, except in instances where the insurance coverage case is a declaratory judgment action concerning whether liability insurance exists for an underlying case that is pending as part of the MDL.

³⁶ www.yrth.net/financial-news/defective-drywall-claims-may-be-covered-under-homeowners-policy-favorable-developments-in-louisiana.

³⁷ www.nldhlaw.com/CM/EmergingTopics/Defective-Drywall-White-Paper.pdf.

³⁸ *Ibid.*

³⁹ www.casact.org/education/spring/2010/handouts/C7-Karlinsky.pdf.

⁴⁰ *Ibid.*

By virtue of the Transfer Order, hundreds of related pending cases in numerous districts were treated as “tag-a-long” actions;^{11/6/11} all involve complaints filed by homeowners and commercial property owners against manufacturers, installers, distributors and home builders regarding the installation of the defective drywall litigation and are non-insurance coverage cases. The initial 10 transferred cases will serve as “test trials” for the defective Chinese-manufactured drywall litigation. “Test trials” often set benchmarks for appropriate damages, making settlements in other pending lawsuits more feasible.⁴¹

Coverage Cases

The *Amerisure Ins. Co. vs. Albanese Popkin The Oaks, Development Grp.* case determined that coverage was triggered under the commercial general liability policy when the damage first occurred; the fact that the damage was continuous in nature did not trigger coverage under an occurrence policy. The insurer sought declaratory judgment requiring them not to defend or indemnify its insured in connection with an underlying lawsuit against the insured homebuilder for damages arising from the installation of defective drywall in a home. Amerisure had issued commercial general liability policies to Albanese Popkin from January 16, 2008 to January 16, 2010. The underlying complaint alleged that damage and a sulfuric odor stemming from the drywall was first noticed in 2006. Therefore, although the damage was continuous through 2008 and 2010, coverage was not triggered under the 2008 to 2009 policies.⁴²

In *Finger v. Audubon Insurance Company*, a Louisiana state court held that the pollution, faulty materials and gradual or sudden loss exclusions did not bar coverage for damages caused by defective drywall. The Court held that under Louisiana law, the pollution exclusion was not intended to apply to residential homeowners claims and the fact the drywall released gases in the home was not sufficient to qualify as a pollutant. The Court further found the gradual or sudden loss exclusion did not apply because the damage was due to off-gassing rather than wear, tear or gradual deterioration. The Court further found that the phrase “rust or other corrosion” did not bar coverage because the rust or corrosion was the damage itself not the cause of the damage. The latent defect exclusion also was not applicable because the Court found no evidence that the defective drywall was damaging or destroying itself. Finally, the Court held the faulty materials exclusion did not apply because the drywall was functioning as intended and performing the purposes of drywall.⁴³ In *Ross v. Louisiana Citizens*, a Louisiana state court did not follow *Finger* and instead rendered summary judgment for the insurer. The *Ross* decision was recently affirmed on appeal⁴⁴.

In *Travco v. Ward*, the insured maintained that the presence of defective drywall had caused damage to air conditioning equipment, a garage door, and flat screen televisions, as well as odorous fumes and family health issues. The insured sought coverage for the cost of removing/replacing the drywall as well as for damages to the air conditioning equipment, garage door, televisions, wiring and other metal components of his home.⁴⁵

The insurer contended that the drywall itself had not suffered a direct physical loss, but did not dispute that damage to the air conditioning equipment, a garage door, televisions and metal components of the home constituted direct physical loss. The federal district of court, applying Virginia law, concluded that the insured’s residence had suffered a direct physical loss as it had been rendered uninhabitable.⁴⁶

The insured’s homeowners policy provided coverage for direct physical loss to the insured’s dwelling and the insured’s personal property. The insured sought coverage under his homeowners policy for damages caused from “off-gassing” from the Defective drywall installed in his home. The insured alleged damages for the costs of removing and/or replacing drywall, damages to his air conditioning unit, garage door, flat screen televisions and wire and copper components of the home. The insurer sought a declaratory judgment stating the homeowners policy did not provide coverage for the claims.⁴⁷

The insurer conceded that the damage to the air conditioner and garage door fell within the policy as “direct physical loss” but the insured was not entitled to coverage based on various exclusions. The court found the insured’s residence had suffered a direct physical loss based on various cases from other jurisdictions. The court determined that even though there was no actual damage to the drywall itself, the home was rendered uninhabitable by the toxic gases released by the drywall. The court, relying on the definition of property damage in the insurance policy, which included “loss of use of tangible property” found the insurer intended to define “direct physical loss” to include total loss of use.⁴⁸

⁴¹ *Ibid.*

⁴² 2010 WL 4942972 (S.D. Fla.).

⁴³ 2010 WL 1222273 (La. Dist. Ct. 2010).

⁴⁴ *Ross v. Adams Const. & Design, L.L.C.*, So.3d, 2011 WL 2328271 (La.App. 5th Cir., 2011)

⁴⁵ 715 F. Supp.2d 699 (E.D. Va. 2010).

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

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The court further concluded, however, that the insured's claims for coverage were barred by the policy's latent defect, faulty materials, corrosion and pollution exclusions. The court held the latent defect exclusion did not apply to the damaged air conditioner or garage door because they were not constructed in a defective manner. However, the court did find that the residence suffered from defects that were integral to the damaged products design, manufacture or construction—the drywall itself. The court found the insured could not argue that the property was damaged, i.e. direct physical loss and simultaneously argue that the property was not damaged, i.e. not subject to the latent defect exclusion. Therefore, the cost of removing and replacing the drywall was excluded by the latent defect exclusion. The court further concluded that even if the drywall was serving its intended purpose the faulty material exclusion barred coverage because the drywall was clearly defective in that it emits toxic gases and chemicals.⁴⁹

The Court also held the corrosion exclusion barred coverage for the losses to the structural, mechanical and plumbing components of the residence because the exclusion precludes recovery for damages caused by corrosion regardless of what caused the corrosion or how suddenly the corrosion occurred. Finally, the Court found the pollution exclusion barred coverage but the exclusion was not limited to traditional environmental pollution and the gases released by the drywall were a pollutant.⁵⁰

The court also concluded that the ensuing loss clauses contained in policy exclusions were not applicable because the currently claimed losses did not occur subsequent to the initial loss, were excluded under the policy or were not covered under the personal property provisions. However, the Court left open the possibility of future claims for damages based on ensuing losses.⁵¹

In re Chinese Manufactured Drywall Products Liability Litigation (HO Coverages), the federal district court in the MDL proceeding concluded that, under Louisiana law, there was no coverage for damages caused by defective drywall. The policies generally provided coverage for direct physical loss (unless excluded); however, some policies also contained a threshold requirement that the loss be “sudden and accidental.” The court concluded that there was physical loss because the claimed damages rendered the homes uninhabitable, the loss was direct because defective drywall was the sole cause, and the loss was sudden and accidental because it was unusual, unexpected and not the result of any willful or intentional acts. The court further found insureds' loss of use of home and damage to electrical wiring, devices, and appliances were not ensuing losses. Homeowners' insurance carriers filed various motions to determine whether coverage was provided under the homeowners policies. The policies generally provided coverage for physical loss to the insureds' homes; however some policies also required the loss to be direct and/or sudden and accidental. The court found coverage under the policies because the defective drywall was releasing elemental sulfur gases throughout the home and renders the homes useless or uninhabitable due to damage to electrical wiring, appliances and the sulfur gas. The court found the “loss of use” was a type of property damage and since the Defective drywall prevents the insureds from fully using and enjoying their homes, therefore, the damage was covered as a physical loss under the policies. Where the policies provided the physical loss must be direct, the court applied a proximate cause analysis finding that since the damage was solely caused by the drywall, the damage was direct. Additionally, the court found coverage was triggered under the policies that require the damage be accidental as the damage caused by the drywall was unusual, unexpected and not the result of any willful or intentional acts.⁵²

After determining that coverage was triggered under the policies, the Court looked at the exclusions in the policies to determine if the damage was excluded. The court concluded that the faulty materials and corrosion exclusion barred coverage. The Court was unable to make a definitive determination as to whether the latent defect exclusion applied. On one hand, the unfinished portions of the drywall boards could be viewed from the attic or unfinished areas to determine if they were defective and the odor and blackened wires were easily detectable. On the other hand, only a skilled worker would immediately recognize the damage to electrical wiring, devices and appliances. The Court found the insurers failed to meet their burden to prove that the latent defect exclusion applied. The Court also held the pollution exclusion did not apply to bar coverage under Louisiana law because the insureds were not the polluters and the defective drywall did not cause the environmental pollution by its presence in the insureds' homes.⁵³

Moreover, the Court held the plaintiffs were entitled to damages for remediation of their home, including removal of the entire electrical system, finding that the wires could not be cleaned so as to remove all corrosion. The court found that all copper and silver plumbing components must be removed and replaced and the entire HVAC system must be removed and replaced. In addition, the Court found that appliances and consumer electronics damaged by the defective drywall must be removed or replaced and that everything in front of the drywall i.e. cabinets, trim, fixtures and porcelain must be removed

⁴⁹ *Ibid.*

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

⁵² *F. Supp. 2d* ___, 2010 WL 5288032 (E.D. La. 2010).

⁵³ *Ibid.*

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and replaced. Flooring may need to be removed and replaced only if damaged during the remediation process. The Court also found that door knobs, strike plates, picture frames, etc which were damaged by corrosion must be replaced. The Court further found a comprehensive cleaning of the home after remediation was necessary as a certification from an independent environmental consultant stating that the remediation was successful. The Court further awarded alternative living costs and pre and post-trial repair costs. However, the Court did not allow damages for lost wages due to missed work because of repairs necessitated by the defective drywall in their home.⁵⁴

The Court did determine that coverage was excluded under the faulty materials provisions in the insurance policies. The Court found that although the drywall served its intended purpose, the drywall was faulty because of the materials of which it was composed. The drywall had a defect or imperfection and moreover, that it would be inconsistent to argue the insureds suffered a loss due to the defective drywall but that the drywall was not in any way faulty. The Court further found that damages due to corrosion were excluded under the corrosion exclusions of the insurance policies because the exclusion applied to all corrosion however brought about.⁵⁵

Liability Cases – Economic Loss Rule

In re Chinese Manufactured Drywall Products Liability Litigation (ELR) the economic loss rule (“ELR”) prevents a plaintiff from bringing tort claims for economic losses when the only damage alleged is to a product caused by the product itself. The doctrine does not bar tort claims for economic losses for damage caused by the product to other property or for personal injuries. ELR did not apply to bar tort claims for damages including economic losses of homeowners who purchased homes containing allegedly defective drywall or bought sheets of allegedly defective drywall under Alabama, Florida or Mississippi law; Louisiana did not recognize the ELR.⁵⁶

Plaintiffs alleged, in some cases, damage to their property and health as a result of allegedly defective Chinese-manufactured drywall. Plaintiffs also alleged the drywall emits sulfide gases and/or other chemicals that cause corrosion of the HVAC coils and refrigerator units, electronic wiring and plumbing components as well as causes rotten-egg-like odors. The plaintiffs further alleged the drywall causes allergic reactions, coughing, sinus and throat infection, eye irritation and respiratory problems.⁵⁷

Distributors alleged the ELR barred recovery for economic damages such as injury to the product, repair costs, inspection costs, relocation costs and diminution in value. Distributors defined the “product” as the purchased home alleging the Defective drywall was merely a component of the product. Therefore, damages caused by the drywall were only to the product itself. Manufacturers similarly argued that tort claims alleged against them were barred by the ELR. Homebuilders alleged that the claims by the Plaintiffs against them were barred by the ELR, but that their claims against the distributors and manufacturers were not barred. Relying upon the history of the ELR as applied in other cases, the Court found the ELR applies to products that fail to meet a plaintiff’s economic expectations rather than products which pose an unreasonable risk of harm to plaintiff’s property and health, but do not fail to meet their intended purpose. Additionally, the ELR is not available where the defective product caused personal injury.⁵⁸

The Court found the ELR did not bar recovery for plaintiffs who purchased defective drywall because the product was clearly the drywall, not the completed homes. The claims of plaintiffs who purchased homes with defective drywall were also not barred. The Court relied, in part, on asbestos cases, analogizing the two. Courts in various jurisdictions have barred application on the ELR to asbestos cases finding that although the asbestos was functioning for its intended purpose, the asbestos releases toxic substances and causes damage to the building and health hazards. Similarly, the Defective drywall does serve its intended purpose but also releases contaminated gasses causing damage to the building and its inhabitants. As a result, the ELR did not bar recovery for plaintiffs’ tort claims.⁵⁹

After the *Finger v. Audubon Insurance Company* case was decided, homeowners brought class actions against a manufacturer of the defective drywall and others alleging negligence, breach of warranties and other consumer protection claims after defective drywall was installed in their homes. The case dealt with the proper measure of damages for the claims. The Court held that damage for loss to real property was cost of repair plus amount of depreciation; homeowners could recover damages for alternative living costs and foreclosure costs; and homeowners were entitled to damages for loss of use and enjoyment of their homes. The case relied on expert testimony to determine the scope of remediation and concluded that the appropriate remediation includes the removal of all drywall, all electrical wiring, all copper pipes, the entire HVAC

⁵⁴ 2010 WL 1710434 (E.D. La. 2010).

⁵⁵ *Ibid.*

⁵⁶ 680 F. Supp. 23 780 (E.D. La. 2010).

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

system and other items including appliances, carpet, cabinetry, trim work and flooring. The Court awarded costs for alternative living expenses during the remediation process as well as costs already incurred by families who had left their homes due to the off-gassing from the defective drywall. The Court declined to award damages for diminution in value finding that if the properties are remediated there may be minimal or no diminution in value. The Court also allowed for damages to personal property where the damage was caused by the defective drywall. The Court awarded total damages for seven properties in the total amount of \$2.6 million dollars.⁶⁰

Finally, the Court determined whether the ensuing loss provisions of the insurance policies provided coverage for losses caused by or resulting from the drywall even though the drywall itself was not covered. The Court held that losses caused by odors emitted from the Defective drywall were not ensuing because they were not different in kind from the losses caused by the drywall, nor the result of an extraneous event. However, the Court did not preclude future recovery for drywall related losses.⁶¹

Federal Legislation

Several federal bills regulating defective drywall were introduced in 2009 and 2010; however, many of these bills have not progressed. This legislation includes H.R. 1977 and S.B. 739: The Drywall Safety Act of 2009; H.R. 1728: The Mortgage Reform and Anti-Predatory Lending Act; H.R. 4094: The Drywall Victims Insurance Protection Act; H.R. 4881: The Toxic Drywall Homeowner Relief Act; S.B. 2850 The Defective Drywall Homeowners Assistance Act and S.B. 2731: The Small Business Administration Disaster Recovery and Reform Act.⁶²

House Bill H.R. 1977: Drywall Safety Act of 2009 was introduced in the House April 2, 2009. The purpose of this bill was to require the Consumer Product Safety Commission to study drywall imported to the United States from China during the years 2004 through 2007. The last action on this bill occurred April 21, 2009; at this time the bill was referred to the House Committee on Energy and Commerce where it was referred to the Subcommittee on Commerce, Trade and Consumer Protection.⁶³

Senate Bill S.B. 739: The Drywall Safety Act of 2009 was introduced to the Senate March 30, 2009. The purpose of this Bill was to require the Consumer Product Safety Commission to study drywall imported to the United States from China during the years 2004 through 2007. This Bill never became law and was cleared from the books.⁶⁴

House Bill H.R. 1728: The Mortgage Reform and Anti-Predatory Lending Act was passed by the House May 7, 2009. Title X, Sec. 1001 addresses a study of the effect of drywall presence on foreclosures. This section states:

- (a) Study—The Secretary of Housing and Urban Development, in consultation with the Secretary of the Treasury, shall conduct a study of the effect on residential mortgage loan foreclosures of
 - (1) the presence in residential structures subject to such mortgage loans of drywall that was imported from China during the period beginning with 2004 and ending at the end of 2007; and
 - (2) the availability of property insurance for residential structures in which such drywall is present.
- (b) Report—Not later than the expiration of the 120-day period beginning on the date of the enactment of this Act, the Secretary of Housing and Urban Development shall submit to the Congress a report on the study conducted under subsection (a) containing its findings, conclusions, and recommendations.⁶⁵

House Bill H.R. 4094: The Drywall Victims Protection Act was introduced to the House Nov. 17, 2009. The purpose of this bill was to prohibit an insurer from issuing discriminatory terms in any renewal of homeowners' coverage based on the presence, or possibility of presence, in the structure of defective drywall. This bill never became law and was cleared from the books.⁶⁶

House Bill H.R. 4881: The Toxic Drywall Homeowner Relief Act was introduced March 18, 2010. The purpose of this Bill was to amend the Internal Revenue Code to allow a deduction from gross income for the cost of removing and remediating drywall installed in a principal residence between 2004 and 2009. This bill never became law.⁶⁷

Senate Bill S.B. 2850: The Defective Drywall Homeowners Assistance Act was introduced Dec. 8, 2009. The purpose of this bill was to permit the use of specified community development block grant (CDBG) funds under the Housing and

⁶⁰ 706 F.Supp.2d 655 (E.D. La 2010).

⁶¹ *Ibid.*

⁶² www.casact.org/education/spring/2010/handouts/C7-Karlinsky.pdf.

⁶³ <http://www.govtrack.us/congress/bill.xpd?bill=h111-1977>.

⁶⁴ <http://www.govtrack.us/congress/bill.xpd?bill=s111-739>.

⁶⁵ <http://www.govtrack.us/congress/bill.xpd?bill=h111-1728>.

⁶⁶ <http://www.govtrack.us/congress/bill.xpd?bill=h111-4094&tab=summary>.

⁶⁷ <http://www.govtrack.us/congress/bill.xpd?bill=h111-4881>.

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Community Development Act of 1974, which have been given to the Road Home Program created by the Louisiana Recovery Authority, to provide any Louisiana resident, whether a participant or nonparticipant in the Road Home Program, with monetary assistance necessary to repair or replace tainted drywall. This bill never became law.⁶⁸

S.B. 2731: The Small Business Administration Disaster Recovery and Reform Act was introduced Nov. 5, 2009. The purpose of this bill was to make recommendations for improvements to the Gulf Coast disaster loan refinancing program. This bill never became law.⁶⁹

Internal Revenue Service Guidance

On Sept. 30, 2010, the Internal Revenue Service issued guidance providing relief to homeowners who have suffered property losses due to the effects of certain imported drywall installed in homes between 2001 and 2009. Revenue Procedure 2010-36 enables affected taxpayers to treat damages from corrosive drywall as a casualty loss and provides a "safe harbor" formula for determining the amount of the loss.⁷⁰

Revenue Procedure 2010-36 provides the following relief:

- Individuals who pay to repair damage to their personal residences or household appliances resulting from corrosive drywall may treat the amount paid as a casualty loss in the year of payment.
- Taxpayers who have already filed their income tax return for the year of payment generally have three years to file an amended return and claim the deduction. The amount of a loss that may be claimed depends on whether the taxpayer has a pending claim for reimbursement (or intends to pursue reimbursement) of the loss through property insurance, litigation or otherwise.
- In cases where a taxpayer does not have a pending claim for reimbursement, the taxpayer may claim as a loss all unreimbursed amounts paid during the taxable year to repair damage to the taxpayer's personal residence and household appliances resulting from corrosive drywall.
- If a taxpayer does have a pending claim (or intends to pursue reimbursement), a taxpayer may claim a loss for 75 percent of the unreimbursed amount paid during the taxable year to repair damage to the taxpayer's personal residence and household appliances that resulted from corrosive drywall.
- A taxpayer who has been fully reimbursed before filing a return for the year the loss was sustained may not claim a loss. A taxpayer who has a pending claim for reimbursement (or intends to pursue reimbursement) may have income or an additional deduction in subsequent taxable years depending on the actual amount of reimbursement received.⁷¹

For purposes of this revenue procedure, the term "corrosive drywall" means drywall that is identified as problem drywall under the two step identification method published by the CPSC and the Department of Housing and Urban Development in their interim guidance dated Jan. 28, 2010.⁷²

State Legislation

Louisiana passed Senate Bill 595 in April 2010 and the bill was signed into law on July 9, 2010. Insurers are now prohibited from dropping coverage of homeowners with defective, Chinese-manufactured drywall. The bill once looked to prohibit commercial and homeowners insurers from dropping or cancelling policies, but in its final version, S.B. 595 stops just homeowners insurers from failing to renew or dropping an insured due to the presence of defective drywall imported before Dec. 31, 2009. Another amendment ensures the bill will not impact premium. Companies can raise rates on the affected homes if the increases are actuarially sound. This law will expire July 31, 2013.⁷³

Florida introduced the Reactive Drywall Mitigation Act Oct. 20, 2009. The purpose of this bill was to prohibit a person from performing an inspection or preparing a plan for the removal of reactive drywall or removing reactive drywall and damaged

⁶⁸ <http://www.govtrack.us/congress/bill.xpd?bill=s111-2850>.

⁶⁹ <http://www.govtrack.us/congress/bill.xpd?bill=s111-2731>.

⁷⁰ <http://www.irs.gov/newsroom/article/0,,id=228402,00.html>.

⁷¹ *Ibid.*

⁷² *Ibid.*

⁷³ <http://www.legis.state.la.us/billdata/streamdocument.asp?did=724019>.

items unless the person is employed by a licensed reactive drywall mitigation business. This bill died in Committee on 11/6/11 Regulated Industries April 30, 2010.⁷⁴

CB/HB 1133 was introduced into the Florida House Feb. 18, 2010. The purpose of this bill was to authorize specified persons or entities to agree to specific measures to effect repairs to improvements to real property due to problems arising from use of reactive drywall. This bill died in the Civil Justice and Courts Policy Committee Apr. 30, 2010.⁷⁵

Conclusion

There are many aspects involved regarding the matter of defective drywall. The problem drywall was imported into the United States between 2004 and 2009, a time in which the southern portion of the United States experienced an atypical hurricane season. There have been over 3,700 reports made to the CPSC regarding the problem drywall. The problem drywall allegedly produces a smell similar to that of rotten eggs, failure of air conditioning equipment and corrosion of pipes, wiring, furniture, fixtures and jewelry. The CPSC has provided interim guidance in conjunction with HUD concerning the identification of the defective drywall. Furthermore, the Federal Interagency Task Force on Problem Drywall has also issued Interim Remediation Guidelines.

General theories of liability have been asserted and consist of, but are not limited to, negligence, strict products liability, breach of warranty, fraudulent concealment and misrepresentation; private nuisance; breach of contract; and violations of deceptive and unfair trade practices. Additionally, there are issues related to insurance coverage, namely, the trigger of coverage and the various exclusions that may apply.

Defective drywall litigation has been filed in federal and state courts. Federal lawsuits regarding the defective drywall were filed in multiple federal districts across the United States and were handled as consolidated cases. Additionally, there have been class action suits brought against the manufacturers of the defective drywall in which the homeowners have been successful in recovering damages. There have been conflicting rulings on defects which leave questions over drywall claims. However, key cases have been identified in this paper.

It should be further noted that Louisiana has a court approved pilot remediation program that is being put into place to remediate approximately 300 homes in Louisiana, Alabama, Mississippi and Florida at no cost to the homeowner. To qualify for the remediation program, the tainted drywall must be manufactured by Knauf Plasterboard Tianjin. This program is a test program. The outcome is still uncertain.⁷⁶

This white paper concludes the NAIC's research on the issue of problem drywall. Resources for updated guidance provided by the CPSC and HUD can be found at: www.cpsc.gov/info/drywall/index.html.

⁷⁴ <http://www.myfloridahouse.gov/Sections/Bills/billsdetail.aspx?BillId=42509&SessionId=0>.

⁷⁵ <http://www.myfloridahouse.gov/sections/Bills/billsdetail.aspx?BillId=43860>.

⁷⁶ <http://www.insurancejournal.com/news/southwestcentral/2011/02/22/187452.htm>

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PROJECT HISTORY

WHITE PAPER ON THE BACKGROUND AND IMPLICATION OF DEFECTIVE DRYWALL October 1, 2011

Project Description

The NAIC Catastrophe Insurance (C) Working Group's purpose in writing this white paper was to inform the Property and Casualty Insurance (C) Committee and regulators on the regulatory, financial and economic impacts of defects reported in drywall imported to the U.S. between 2004 and 2007, as well as to examine property damage and bodily injury claims related to exposure to the defective drywall.

The white paper is an educational white paper, rather than one containing advocacy for a particular position. The white paper includes an overview of the defective drywall issue, which has been discussed by the Working Group. The white paper also includes discussion of interim guidance provided by the U.S. Consumer Product Safety Commission, possible property damage and bodily injury exposures, and the various theories of liability that are being seen in some of the pending lawsuits. Due to the number of seminars available on the topic of the defective drywall, the possibility for class-action lawsuits exists. Some of the existing lawsuits have been consolidated, so there are multiple judgments coming down at the same time—combinations of strict liability breach of warranty, fraudulent concealment and misrepresentation, private nuisance, breach of contract, vicarious liability, unjust enrichment, and unfair trade practices statutes. The white paper also addresses the triggers of coverage in first-party claims and third-party claims. The white paper speaks to some of the defenses that might be seen in the exclusions in the commercial general liability policies and in the homeowners policy exclusions. The white paper discusses potential remedies, including litigation and state and federal solutions. Currently, there are more questions than answers; therefore, the conclusion is brief. The white paper includes references for those who wish to further research the matter.

Group Responsible for the Report

The following states were members of the Working Group: Florida, Chair; Alabama; California; Connecticut; Hawaii; Louisiana; Massachusetts; Mississippi; New Jersey; Ohio; Oklahoma; South Carolina; Tennessee; and Virginia.

Parent Committee Charge Authorizing Project

The Property and Casualty Insurance (C) Committee is the parent committee for the NAIC membership of the Catastrophe Insurance (C) Working Group. The following Committee charge was adopted to encompass the Working Group's activities:

- Investigate the regulatory, financial and economic impacts of defects reported in drywall imported to the U.S. between 2004 and 2007. Examine property damage and bodily injury claims related to exposure to defective drywall.

This charge was initially given to the Working Group in the fall of 2010.

General Description of Drafting Process

At the 2010 Spring National Meeting, the Working Group began assessing the impact of defects reported in drywall imported into the U.S. NAIC staff began to put together a white paper on the subject. At that time there was still speculation on the mitigation of the defective drywall problems, as the mitigation process was still in its early phases.

The Working Group discussed the first piece of litigation that had gone to trial. Due to the fact that the courts were going to be responsible for determining the nature and scope of the remediation and costs of repairs, it would be more feasible to produce a white paper on the topic as these cases were settled. NAIC staff kept track of what was going on with this matter and the NAIC was to draft the white paper for review by the Working Group at the 2010 Summer National Meeting.

The Working Group was presented with a draft white paper at the 2010 Summer National Meeting. The Working Group received the white paper and exposed it for a 30-day comment period.

During the 2010 Fall National Meeting, the Working Group discussed the comments received. NAIC staff were to make changes to the white paper based on the comments received and to incorporate recent court actions.

The Working Group discussed the revised version of the white paper at the 2011 Spring National Meeting. The Working Group members were asked to review the revised version of the white paper, and a conference call was scheduled for April 2011 to consider adoption of the white paper.

The Working Group met via conference call April 26, 2011 and adopted the white paper accompanied with a copy of comments received from the American Insurance Association (AIA). The white paper was to be considered for adoption by the Property and Casualty Insurance (C) Committee during the 2011 Summer National Meeting.

The 2011 Summer National Meeting was cancelled due to Hurricane Irene; therefore, the Property and Casualty Insurance (C) Committee met via conference call Sept. 16, 2011. Commissioner Mike Chaney (MS) noted that since the defective drywall white paper was adopted by the Catastrophe Insurance (C) Working Group during its April 26 conference call, it had been updated to incorporate comments by the AIA that were included as an attachment. He said a white paper with an attachment amending it is cumbersome for the reader. He said that the NAIC staff has incorporated most of the changes suggested by the AIA into the body of the white paper. Commissioner Kevin M. McCarty (FL) said he reviewed the edits made by NAIC staff and believed they were acceptable. Upon a motion by Commissioner McCarty, and second by Director Bruce R. Ramge (NE), the Committee, by unanimous voice vote, adopted the white paper *The Background and Implications of Defective Drywall*.

The meetings and conference calls of the Working Group were all open. Drafts of the white paper have regularly been circulated to members and interested parties. Interested parties have been actively involved in the discussions and in reviewing the report.

**Report of the
Market Regulation and Consumer Affairs (D) Committee**

The Market Regulation and Consumer Affairs (D) Committee met Nov. 5, 2011. During this meeting, the Committee:

1. Adopted the Complaint Reconciliation Proposal.
2. Adopted its 2012 Proposed Charges.
3. Adopted its task force and working group reports: Antifraud (D) Task Force; Market Information Systems (D) Task Force; Consumer Connections (D) Working Group; Consumer Disclosures (D) Working Group; Market Conduct Examination Standards (D) Working Group; Social Media in Insurance (D) Working Group; Limited Medical Benefits Plan (B/D) Working Group; and Market Actions (D) Working Group.

Report of Financial Condition (E) Committee

The Financial Condition (E) Committee met Nov. 5, 2011. During this meeting, the Committee:

1. Received comments and further discussed a response memorandum from the Life Actuarial (A) Task Force regarding separate account issues. The Committee and various other NAIC groups have been investigating various accounting, reporting and risk issues related to separate accounts over the past few years. The Committee directed NAIC staff to develop additional charges to address the following:
 - Request that the Financial Condition Examiners (E) Technical Group consider the current examination processes and procedures related to separate accounts products/assets to ensure that adequate consideration is given to potential risks arising from these accounts. Additionally, request that the Technical Group consider the recent changes in the *Financial Analysis Handbook* and how to leverage the analyst's work to identify areas for examination activities.
 - Request that the Receivership Separate Account (E) Working Group consider reporting needs for current separate accounts mix of products and assets due to considerations with insulated and non-insulated products/assets.
 - Request that the Separate Account Risk (E) Working Group compare U.S. generally accepted accounting principles (GAAP) definition and requirements for separate accounts to statutory accounting requirements and use the results to help discuss what should be allowed as insulated products.
2. Received a response memorandum from the Financial Analysis Handbook (E) Working Group regarding a referral from the Committee for enhancement of the *Financial Analysis Handbook*, specifically to address the need for additional analytical procedures related to separate accounts.
3. Adopted its 2012 Proposed Charges. The Committee discussed a new 2011 and 2012 charge recently received from the Executive (EX) Committee with respect to insurers' use of captives and special purpose vehicles to transfer third party insurance risk. The Committee is establishing a new subgroup to accomplish this charge. The subgroup will consist of two members from each of the following groups: Financial Analysis (E) Working Group, Life Actuarial (A) Task Force and the Reinsurance (E) Task Force.
4. Discussed the Executive (EX) Committee's establishment of a joint subgroup of the Life Insurance and Annuities (A) Committee and Financial Condition (E) Committee to address any implications related to the Statement on *Actuarial Guideline XXXVIII: The Application of the Valuation of Life Insurance Policies Model Regulation (#830)*, which was adopted Nov. 1 by the Life Actuarial (A) Task Force.
5. Received an update from the Group Solvency Issues (EX) Working Group regarding the Working Group's recent activities related to the Own Risk and Solvency Assessment (ORSA).
6. Authorized all of its subsidiary task forces and working groups to continue working after this meeting. If any work products require adoption prior to year-end, the Committee will schedule a conference call as necessary to address these items.

Draft: 7/14/11

Revisions to Model 312 to add fraternal benefit societies to the model.

Released for comment at a July 14, 2011 conference call by the Capital Adequacy (E) Task Force.

Underlining and overstrikes show the changes from the existing model. Comments are being requested on this draft.

Comments should be submitted by email only by Monday, Aug. 15, 2011, to Dan Swanson at dswanson@naic.org.

RISK-BASED CAPITAL (RBC) FOR INSURERS MODEL ACT

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Section 1. Definitions

As used in this Act, these terms shall have the following meanings:

- A. “Adjusted RBC Report” means an RBC report which has been adjusted by the commissioner in accordance with Section 2E.
- B. “Corrective order” means an order issued by the commissioner specifying corrective actions which the commissioner has determined are required.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term “commissioner” appears.

- C. “Domestic insurer” means any insurance company domiciled in this state.
- D. “Foreign insurer” means any insurance company which is licensed to do business in this State under [cite appropriate statute] but is not domiciled in this State.

Drafting Note: The drafting committee does not recommend application of the risk-based capital model act to any insurance company organized under the laws of any state of the United States if such company (1) has a provision in its certificate of incorporation (or like corporate instrument) prohibiting the doing of insurance business with persons or entities which are citizens or residents of, or organized or located within, the United States and (2) does not, in fact, do insurance business with such persons or entities, so that none of its insurance liabilities are to any such person or entity.

- E. “NAIC” means the National Association of Insurance Commissioners.
- F. “Life and/or health insurer” means any insurance company licensed under Section [cite appropriate statute], or a licensed property and casualty insurer writing only accident and health insurance.

Drafting Note: The drafting committee did not specifically examine, and expresses no opinion with respect to, the application of the risk-based capital formula to fraternal benefit societies, health service organizations, dental service organizations, health maintenance organizations, dental plan organizations or mutual benefit associations (including without limitation Blue Cross/Blue Shield organizations). States may wish to consider the application of the risk-based capital model act to these entities, or any of them.

G. “Fraternal benefit society” means any insurance company licensed under Section [cite appropriate statute].

GH. “Property and casualty insurer” means any insurance company licensed under Section [cite appropriate statute] but shall not include monoline mortgage guaranty insurers, financial guaranty insurers and title insurers.

Drafting Note: The drafting committee did not specifically examine, and expresses no opinion with respect to, the application of the risk-based capital formula to farm and county mutuals, health service organizations, dental service organizations, health maintenance organizations, dental plan organizations or any single state specialty insurer not subject to rules and regulations applicable to property and casualty insurers. States may wish to consider the application of the risk-based capital model act to these entities, or any of them.

IH. “Negative trend” means, with respect to a life and/or health insurer, negative trend over a period of time, as determined in accordance with the “Trend Test Calculation” included in the Life RBC Instructions.

IJ. “RBC instructions” means the RBC Report including risk-based capital instructions adopted by the NAIC, as such RBC Instructions may be amended by the NAIC from time to time in accordance with the procedures adopted by the NAIC.

JK. “RBC Level” means an insurer’s Company Action Level RBC, Regulatory Action Level RBC, Authorized Control Level RBC, or Mandatory Control Level RBC where:

- (1) “Company Action Level RBC” means, with respect to any insurer, the product of 2.0 and its Authorized Control Level RBC;
- (2) “Regulatory Action Level RBC” means the product of 1.5 and its Authorized Control Level RBC;
- (3) “Authorized Control Level RBC” means the number determined under the risk-based capital formula in accordance with the RBC Instructions;
- (4) “Mandatory Control Level RBC” means the product of .70 and the Authorized Control Level RBC.

KL. “RBC Plan” means a comprehensive financial plan containing the elements specified in Section 3B. If the commissioner rejects the RBC Plan, and it is revised by the insurer, with or without the commissioner’s recommendation, the plan shall be called the “Revised RBC Plan.”

LM. “RBC Report” means the report required in Section 2.

MN. “Total adjusted capital” means the sum of:

- (1) An insurer’s statutory capital and surplus as determined in accordance with the statutory accounting applicable to the annual financial statements required to be filed under [cite appropriate statute]; and
- (2) Such other items, if any, as the RBC instructions may provide.

Section 2. RBC Reports

- A. Every domestic insurer shall, on or prior to each March 1 (the “filing date”), prepare and submit to the commissioner a report of its RBC Levels as of the end of the calendar year just ended, in a form and containing such information as is required by the RBC instructions. In addition, every domestic insurer shall file its RBC Report:
- (1) With the NAIC in accordance with the RBC instructions; and
 - (2) With the insurance commissioner in any state in which the insurer is authorized to do business, if the insurance commissioner has notified the insurer of its request in writing, in which case the insurer shall file its RBC Report not later than the later of:
 - (a) Fifteen (15) days from the receipt of notice to file its RBC Report with that state; or
 - (b) The filing date.
- B. A life and health insurer’s **or fraternal benefit society’s** RBC shall be determined in accordance with the formula set forth in the RBC instructions. The formula shall take into account (and may adjust for the covariance between) the following factors determined in each case by applying the factors in the manner set forth in the RBC instructions.
- (1) The risk with respect to the insurer’s assets;
 - (2) The risk of adverse insurance experience with respect to the insurer’s liabilities and obligations;
 - (3) The interest rate risk with respect to the insurer’s business; and
 - (4) All other business risks and such other relevant risks as are set forth in the RBC instructions.
- C. A property and casualty insurer’s RBC shall be determined in accordance with the formula set forth in the RBC instructions. The formula shall take the following into account (and may adjust for the covariance between) determined in each case by applying the factors in the manner set forth in the RBC instructions.
- (1) Asset risk;
 - (2) Credit risk;
 - (3) Underwriting risk; and
 - (4) All other business risks and such other relevant risks as are set forth in the RBC instructions.
- D. An excess of capital over the amount produced by the risk-based capital requirements contained in the Act and the formulas, schedules and instructions referenced in this Act is desirable in the business of insurance. Accordingly, insurers should seek to maintain capital above the RBC levels required by this Act. Additional capital is used and useful in the insurance business and helps to secure an insurer against various risks inherent in, or affecting, the business of insurance and not accounted for or only partially measured by the risk-based capital requirements contained in this Act.
- E. If a domestic insurer files an RBC Report which in the judgment of the commissioner is inaccurate, then the commissioner shall adjust the RBC Report to correct the inaccuracy and shall notify the insurer of the adjustment. The notice shall contain a statement of the reason for the adjustment. An RBC Report as so adjusted is referred to as an “Adjusted RBC Report.”

Section 3. Company Action Level Event

- A. “Company Action Level Event” means any of the following events:
- (1) The filing of an RBC Report by an insurer which indicates that:
 - (a) The insurer’s total adjusted capital is greater than or equal to its Regulatory Action Level RBC but less than its Company Action Level RBC;
 - (b) If a life and/or health insurer or a fraternal benefit society, the insurer or society has total adjusted capital which is greater than or equal to its Company Action Level RBC but less than the product of its Authorized Control Level RBC and 2.5 and has a negative trend; or
 - (c) If a property and casualty insurer, the insurer has total adjusted capital which is greater than or equal to its Company Action Level RBC but less than the product of its Authorized Control Level RBC and 3.0 and triggers the trend test determined in accordance with the trend test calculation included in the Property and Casualty RBC instructions;
 - (2) The notification by the commissioner to the insurer of an Adjusted RBC Report that indicates an event in Paragraph (1) of this subsection, provided the insurer does not challenge the Adjusted RBC Report under Section 7; or
 - (3) If, pursuant to Section 7, an insurer challenges an Adjusted RBC Report that indicates the event in Paragraph (1) of this subsection, the notification by the commissioner to the insurer that the commissioner has, after a hearing, rejected the insurer’s challenge.
- B. In the event of a Company Action Level Event, the insurer shall prepare and submit to the commissioner an RBC Plan which shall:
- (1) Identify the conditions which contribute to the Company Action Level Event;
 - (2) Contain proposals of corrective actions which the insurer intends to take and would be expected to result in the elimination of the Company Action Level Event;
 - (3) Provide projections of the insurer’s financial results in the current year and at least the four (4) succeeding years, both in the absence of proposed corrective actions and giving effect to the proposed corrective actions, including projections of statutory operating income, net income, capital and surplus. (The projections for both new and renewal business might include separate projections for each major line of business and separately identify each significant income, expense and benefit component);
 - (4) Identify the key assumptions impacting the insurer’s projections and the sensitivity of the projections to the assumptions; and
 - (5) Identify the quality of, and problems associated with, the insurer’s business, including but not limited to its assets, anticipated business growth and associated surplus strain, extraordinary exposure to risk, mix of business and use of reinsurance, if any, in each case.

- C. The RBC Plan shall be submitted
- (1) Within forty-five (45) days of the Company Action Level Event; or
 - (2) If the insurer challenges an Adjusted RBC Report pursuant to Section 7, within forty-five (45) days after notification to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge.
- D. Within sixty (60) days after the submission by an insurer of an RBC Plan to the commissioner, the commissioner shall notify the insurer whether the RBC Plan shall be implemented or is, in the judgment of the commissioner, unsatisfactory. If the commissioner determines the RBC Plan is unsatisfactory, the notification to the insurer shall set forth the reasons for the determination, and may set forth proposed revisions which will render the RBC Plan satisfactory, in the judgment of the commissioner. Upon notification from the commissioner, the insurer shall prepare a Revised RBC Plan, which may incorporate by reference any revisions proposed by the commissioner, and shall submit the Revised RBC Plan to the commissioner:
- (1) Within forty-five (45) days after the notification from the commissioner; or
 - (2) If the insurer challenges the notification from the commissioner under Section 7, within forty-five (45) days after a notification to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge.
- E. In the event of a notification by the commissioner to an insurer that the insurer's RBC Plan or Revised RBC Plan is unsatisfactory, the commissioner may at the commissioner's discretion, subject to the insurer's right to a hearing under Section 7, specify in the notification that the notification constitutes a Regulatory Action Level Event.
- F. Every domestic insurer that files an RBC Plan or Revised RBC Plan with the commissioner shall file a copy of the RBC Plan or Revised RBC Plan with the insurance commissioner in any state in which the insurer is authorized to do business if:
- (1) Such state has an RBC provision substantially similar to Section 8A; and
 - (2) The insurance commissioner of that state has notified the insurer of its request for the filing in writing, in which case the insurer shall file a copy of the RBC Plan or Revised RBC Plan in that state no later than the later of:
 - (a) Fifteen (15) days after the receipt of notice to file a copy of its RBC Plan or Revised RBC Plan with the state; or
 - (b) The date on which the RBC Plan or Revised RBC Plan is filed under Section 3C and 3D.

Section 4. Regulatory Action Level Event

- A. "Regulatory Action Level Event" means, with respect to any insurer, any of the following events:
- (1) The filing of an RBC Report by the insurer which indicates that the insurer's total adjusted capital is greater than or equal to its Authorized Control Level RBC but less than its Regulatory Action Level RBC;
 - (2) The notification by the commissioner to an insurer of an Adjusted RBC Report that indicates the event in Paragraph (1), provided the insurer does not challenge the Adjusted RBC Report under Section 7;

- (3) If, pursuant to Section 7, the insurer challenges an Adjusted RBC Report that indicates the event in Paragraph (1), the notification by the commissioner to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge;
 - (4) The failure of the insurer to file an RBC Report by the filing date, unless the insurer has provided an explanation for such failure which is satisfactory to the commissioner and has cured the failure within ten (10) days after the filing date;
 - (5) The failure of the insurer to submit an RBC Plan to the commissioner within the time period set forth in Section 3C;
 - (6) Notification by the commissioner to the insurer that
 - (a) The RBC Plan or revised RBC Plan submitted by the insurer is, in the judgment of the commissioner, unsatisfactory; and
 - (b) Such notification constitutes a Regulatory Action Level Event with respect to the insurer, provided the insurer has not challenged the determination under Section 7;
 - (7) If, pursuant to Section 7, the insurer challenges a determination by the commissioner under Paragraph (6), the notification by the commissioner to the insurer that the commissioner has, after a hearing, rejected such challenge;
 - (8) Notification by the commissioner to the insurer that the insurer has failed to adhere to its RBC Plan or Revised RBC Plan, but only if such failure has a substantial adverse effect on the ability of the insurer to eliminate the Company Action Level Event in accordance with its RBC Plan or Revised RBC Plan and the commissioner has so stated in the notification, provided the insurer has not challenged the determination under Section 7; or
 - (9) If, pursuant to Section 7, the insurer challenges a determination by the commissioner under Paragraph (8), the notification by the commissioner to the insurer that the commissioner has, after a hearing, rejected the challenge.
- B. In the event of a Regulatory Action Level Event the commissioner shall:
- (1) Require the insurer to prepare and submit an RBC Plan or, if applicable, a Revised RBC Plan;
 - (2) Perform such examination or analysis as the commissioner deems necessary of the assets, liabilities and operations of the insurer including a review of its RBC Plan or Revised RBC Plan; and
 - (3) Subsequent to the examination or analysis, issue an order specifying such corrective actions as the commissioner shall determine are required (a "corrective order").
- C. In determining corrective actions, the commissioner may take into account such factors as are deemed relevant with respect to the insurer based upon the commissioner's examination or analysis of the assets, liabilities and operations of the insurer, including, but not limited to, the results of any sensitivity tests undertaken pursuant to the RBC instructions. The RBC Plan or Revised RBC Plan shall be submitted:
- (1) Within forty-five (45) days after the occurrence of the Regulatory Action Level Event;
 - (2) If the insurer challenges an Adjusted RBC Report pursuant to Section 7 and the challenge is not frivolous in the judgment of the commissioner within forty-five (45) days after the notification to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge; or

(3) If the insurer challenges a Revised RBC Plan pursuant to Section 7 and the challenge is not frivolous in the judgment of the commissioner, within forty-five (45) days after the notification to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge.

D. The commissioner may retain actuaries and investment experts and other consultants as may be necessary in the judgment of the commissioner to review the insurer's RBC Plan or Revised RBC Plan, examine or analyze the assets, liabilities and operations of the insurer and formulate the corrective order with respect to the insurer. The fees, costs and expenses relating to consultants shall be borne by the affected insurer or such other party as directed by the commissioner.

Section 5. Authorized Control Level Event

A. "Authorized Control Level Event" means any of the following events:

- (1) The filing of an RBC Report by the insurer which indicates that the insurer's total adjusted capital is greater than or equal to its Mandatory Control Level RBC but less than its Authorized Control Level RBC;
- (2) The notification by the commissioner to the insurer of an Adjusted RBC Report that indicates the event in Paragraph (1), provided the insurer does not challenge the Adjusted RBC Report under Section 7;
- (3) If, pursuant to Section 7, the insurer challenges an Adjusted RBC Report that indicates the event in Paragraph (1), notification by the commissioner to the insurer that the commissioner has, after a hearing, rejected the insurer's challenge;
- (4) The failure of the insurer to respond, in a manner satisfactory to the commissioner, to a corrective order (provided the insurer has not challenged the corrective order under Section 7); or
- (5) If the insurer has challenged a corrective order under Section 7 and the commissioner has, after a hearing, rejected the challenge or modified the corrective order, the failure of the insurer to respond, in a manner satisfactory to the commissioner, to the corrective order subsequent to rejection or modification by the commissioner.

B. In the event of an Authorized Control Level Event with respect to an insurer, the commissioner shall:

- (1) Take such actions as are required under Section 4 regarding an insurer with respect to which an Regulatory Action Level Event has occurred; or
- (2) If the commissioner deems it to be in the best interests of the policyholders and creditors of the insurer and of the public, take such actions as are necessary to cause the insurer to be placed under regulatory control under [insert reference to relevant insurance company rehabilitation and liquidation act]. In the event the commissioner takes such actions, the Authorized Control Level Event shall be deemed sufficient grounds for the commissioner to take action under [insert same reference], and the commissioner shall have the rights, powers and duties with respect to the insurer as are set forth in [insert same reference]. In the event the commissioner takes actions under this paragraph pursuant to an Adjusted RBC Report, the insurer shall be entitled to such protections as are afforded to insurers under the provisions of Section [insert reference] pertaining to summary proceedings.

Section 6. Mandatory Control Level Event

- A. “Mandatory Control Level Event” means any of the following events:
- (1) The filing of an RBC Report which indicates that the insurer’s total adjusted capital is less than its Mandatory Control Level RBC;
 - (2) Notification by the commissioner to the insurer of an Adjusted RBC Report that indicates the event in Paragraph (1), provided the insurer does not challenge the Adjusted RBC Report under Section 7; or
 - (3) If, pursuant to Section 7, the insurer challenges an Adjusted RBC Report that indicates the event in Paragraph (1), notification by the commissioner to the insurer that the commissioner has, after a hearing, rejected the insurer’s challenge.
- B. In the event of a Mandatory Control Level Event:
- (1) With respect to a life insurer or fraternal benefit society, the commissioner shall take such actions as are necessary to place the insurer under regulatory control under [insert reference to relevant insurance company rehabilitation and liquidation act]. In that event, the Mandatory Control Level Event shall be deemed sufficient grounds for the commissioner to take action under [insert same reference], and the commissioner shall have the rights, powers and duties with respect to the insurer as are set forth in [insert same reference]. If the commissioner takes actions pursuant to an Adjusted RBC Report, the insurer shall be entitled to the protections of Section [insert reference] pertaining to summary proceedings. Notwithstanding any of the foregoing, the commissioner may forego action for up to ninety (90) days after the Mandatory Control Level Event if the commissioner finds there is a reasonable expectation that the Mandatory Control Level Event may be eliminated within the ninety (90) day period.
 - (2) With respect to a property and casualty insurer, the commissioner shall take such actions as are necessary to place the insurer under regulatory control under [insert reference to relevant insurance company rehabilitation and liquidation act], or, in the case of an insurer which is writing no business and which is running-off its existing business, may allow the insurer to continue its run-off under the supervision of the commissioner. In either event, the Mandatory Control Level Event shall be deemed sufficient grounds for the commissioner to take action under [insert same reference] and the commissioner shall have the rights, powers and duties with respect to the insurer as are set forth in [insert same reference]. If the commissioner takes actions pursuant to an Adjusted RBC Report, the insurer shall be entitled to the protections of Section [insert reference] pertaining to summary proceedings. Notwithstanding any of the foregoing, the commissioner may forego action for up to ninety (90) days after the Mandatory Control Level Event if the commissioner finds there is a reasonable expectation that the Mandatory Control Level Event may be eliminated within the ninety (90) day period.

Section 7. Hearings

Upon any of the following the insurer shall have the right to a confidential departmental hearing, on a record, at which the insurer may challenge any determination or action by the commissioner. The insurer shall notify the commissioner of its request for a hearing within five (5) days after the notification by the commissioner under Subsection A, B, C or D. Upon receipt of the insurer’s request for a hearing, the commissioner shall set a date for the hearing, which date shall be no less than ten (10) nor more than thirty (30) days after the date of the insurer’s request.

- A. Notification to an insurer by the commissioner of an Adjusted RBC Report; or
- B. Notification to an insurer by the commissioner that

- (1) The insurer's RBC Plan or Revised RBC Plan is unsatisfactory; and
 - (2) Such notification constitutes a Regulatory Action Level Event with respect to such insurer; or
- C. Notification to any insurer by the commissioner that the insurer has failed to adhere to its RBC Plan or Revised RBC Plan and that such failure has a substantial adverse effect on the ability of the insurer to eliminate the Company Action Level Event with respect to the insurer in accordance with its RBC Plan or Revised RBC Plan; or
- D. Notification to an insurer by the commissioner of a corrective order with respect to the insurer.

Section 8. Confidentiality; Prohibition on Announcements, Prohibition on Use in Ratemaking

- A. All RBC Reports (to the extent the information therein is not required to be set forth in a publicly available annual statement schedule) and RBC Plans (including the results or report of any examination or analysis of an insurer performed pursuant hereto and any corrective order issued by the commissioner pursuant to examination or analysis) with respect to any domestic insurer or foreign insurer that are in the possession or control of the Department of Insurance shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information, sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. However, the commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner's official duties.
- B. Neither the commissioner nor any person who received documents, materials or other information while acting under the authority of the commissioner shall be permitted or required to testify in any private civil action concerning any confidential documents, materials or information subject to Subsection A.
- C. In order to assist in the performance of the commissioner's duties, the commissioner:
- (1) May share documents, materials or other information, including the confidential and privileged documents, materials or information subject to Subsection A, with other state, federal and international regulatory agencies, with the NAIC and its affiliates and subsidiaries, and with state, federal and international law enforcement authorities, provided that the recipient agrees to maintain the confidentiality and privileged status of the document, material or other information;
 - (2) May receive documents, materials or information, including otherwise confidential and privileged documents, materials or information, from the NAIC and its affiliates and subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information; and
 - (3) [Optional provision] May enter into agreements governing sharing and use of information consistent with this subsection.

Drafting Note: The language in Subsection C(1) assumes the recipient has the authority to protect the applicable confidentiality or privilege, but does not address the verification of that authority, which would presumably occur in the context of a broader information sharing agreement.

- D. No waiver of any applicable privilege or claim of confidentiality in the documents, materials or information shall occur as a result of disclosure to the commissioner under this section or as a result of sharing as authorized in Subsection C.

- E. It is the judgment of the legislature that the comparison of an insurer's Total Adjusted Capital to any of its RBC Levels is a regulatory tool which may indicate the need for possible corrective action with respect to the insurer, and is not intended as a means to rank insurers generally. Therefore, except as otherwise required under the provisions of this Act, the making, publishing, disseminating, circulating or placing before the public, or causing, directly or indirectly to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio or television station, or in any other way, an advertisement, announcement or statement containing an assertion, representation or statement with regard to the RBC Levels of any insurer, or of any component derived in the calculation, by any insurer, agent, broker or other person engaged in any manner in the insurance business would be misleading and is therefore prohibited; provided, however, that if any materially false statement with respect to the comparison regarding an insurer's Total Adjusted Capital to its RBC Levels (or any of them) or an inappropriate comparison of any other amount to the insurers' RBC Levels is published in any written publication and the insurer is able to demonstrate to the commissioner with substantial proof the falsity of such statement, or the inappropriateness, as the case may be, then the insurer may publish an announcement in a written publication if the sole purpose of the announcement is to rebut the materially false statement.
- F. It is the further judgment of the legislature that the RBC Instructions, RBC Reports, Adjusted RBC Reports, RBC Plans and Revised RBC Plans are intended solely for use by the commissioner in monitoring the solvency of insurers and the need for possible corrective action with respect to insurers and shall not be used by the commissioner for ratemaking nor considered or introduced as evidence in any rate proceeding nor used by the commissioner to calculate or derive any elements of an appropriate premium level or rate of return for any line of insurance which an insurer or an affiliate is authorized to write.

Section 9. Supplemental Provisions; Rules; Exemption

- A. The provisions of this Act are supplemental to any other provisions of the laws of this state, and shall not preclude or limit any other powers or duties of the commissioner under such laws, including, but not limited to, [cite rehabilitation and liquidation law and law pertaining to insurers in hazardous financial condition].
- B. The commissioner may adopt reasonable rules necessary for the implementation of this Act.
- C. The commissioner may exempt from the application of this Act any domestic property and casualty insurer which;
- (1) Writes direct business only in this state;
 - (2) Writes direct annual premiums of [\$X] or less; and
 - (3) Assumes no reinsurance in excess of five percent (5%) of direct premium written.

Drafting Note: It is the drafters' intent that the domiciliary commissioner have the ability to exempt certain insurers doing business only within the commissioner's jurisdiction. The intent is to limit this exemption to insurers that do not write in excess of \$2,000,000 in annual premiums.

Section 10. Foreign Insurers

- A. Any foreign insurer shall, upon the written request of the commissioner, submit to the commissioner an RBC Report as of the end of the calendar year just ended the later of:
- (1) The date an RBC Report would be required to be filed by a domestic insurer under this Act; or
 - (2) Fifteen (15) days after the request is received by the foreign insurer.

Any foreign insurer shall, at the written request of the commissioner, promptly submit to the commissioner a copy of any RBC Plan that is filed with the insurance commissioner of any other state.

- B. In the event of a Company Action Level Event, Regulatory Action Level Event or Authorized Control Level Event with respect to any foreign insurer as determined under the RBC statute applicable in the state of domicile of the insurer (or, if no RBC statute is in force in that state, under the provisions of this Act), if the insurance commissioner of the state of domicile of the foreign insurer fails to require the foreign insurer to file an RBC Plan in the manner specified under that state's RBC statute (or, if no RBC statute is in force in that state, under Section 3 hereof), the commissioner may require the foreign insurer to file an RBC Plan with the commissioner. In such event, the failure of the foreign insurer to file an RBC Plan with the commissioner shall be grounds to order the insurer to cease and desist from writing new insurance business in this state.
- C. In the event of a Mandatory Control Level Event with respect to any foreign insurer, if no domiciliary receiver has been appointed with respect to the foreign insurer under the rehabilitation and liquidation statute applicable in the state of domicile of the foreign insurer, the commissioner may make application to the [cite appropriate state court] permitted under the [cite rehabilitation and liquidation statute] with respect to the liquidation of property of foreign insurers found in this state, and the occurrence of the Mandatory Control Level Event shall be considered adequate grounds for the application.

Section 11. Immunity

There shall be no liability on the part of, and no cause of action shall arise against, the commissioner or the insurance department or its employees or agents for any action taken by them in the performance of their powers and duties under this Act.

Section 12. Severability Clause

If any provision of this Act, or the application thereof to any person or circumstance, is held invalid, such determination shall not affect the provisions or applications of this Act which can be given effect without the invalid provision or application, and to that end the provisions of this Act are severable.

Section 13. Notices

All notices by the commissioner to an insurer which may result in regulatory action hereunder shall be effective upon dispatch if transmitted by registered or certified mail, or in the case of any other transmission shall be effective upon the insurer's receipt of such notice.

Section 14. Phase-In Provision

- A. For RBC Reports required to be filed by life insurers with respect to 1993, the following requirements shall apply in lieu of the provisions of Section 3, 4, 5 and 6:
- (1) In the event of a Company Action Level Event with respect to a domestic insurer, the commissioner shall take no regulatory action hereunder.
 - (2) In the event of an Regulatory Action Level Event under Section 4A(1), (2) or (3) the commissioner shall take the actions required under Section 3.
 - (3) In the event of an Regulatory Action Level Event under Section 4A(4), (5), (6), (7), (8) or (9) or an Authorized Control Level Event, the commissioner shall take the actions required under Section 4 with respect to the insurer.

- (4) In the event of a Mandatory Control Level Event with respect to an insurer, the commissioner shall take the actions required under Section 5 with respect to the insurer.

Drafting Note: This provision should be included for states which adopt the model law in 1993 for implementation in 1994 (based on 1993 annual statements).

B. For RBC Reports required to be filed by property and casualty insurers with respect to 1994, the following requirements shall apply in lieu of the provisions of Section 3, 4, 5 and 6:

- (1) In the event of a Company Action Level Event with respect to a domestic insurer, the commissioner shall take no regulatory action hereunder.
- (2) In the event of an Regulatory Action Level Event under Section 4A(1), (2) or (3) the commissioner shall take the actions required under Section 3.
- (3) In the event of an Regulatory Action Level Event under Section 4A(4), (5), (6), (7), (8) or (9) or an Authorized Control Level Event, the commissioner shall take the actions required under Section 4 with respect to the insurer.
- (4) In the event of a Mandatory Control Level Event with respect to an insurer, the commissioner shall take the actions required under Section 5 with respect to the insurer.

Drafting Note: This provision should be included for states which adopt the model law as amended to include property and casualty insurers or which adopt the property and casualty amendments in 1994 for implementation in 1995 (based on 1994 annual statements).

Section 15. Effective Date

This Act shall become effective immediately upon its enactment.

Legislative History (all references are to the Proceedings of the NAIC).

*1993 Proc. 18, 137, 275-276, 556-557, 559-565, (adopted model applying only to life and health insurers).
1993 Proc. 4th Quarter 16, 20, 163, 390-398 (amended to include property and casualty insurers and reprinted).
1994 Proc. 3rd Quarter 14, 58, 264, 316, 347-356 (amended and reprinted).
1999 Proc. 4th Quarter 15, 364, 369, 375-376 (amended).
2006 Proc. 1st Quarter 36, 44-52 (amended).*

PROJECT HISTORY

CHANGES TO THE *RISK-BASED CAPITAL FOR INSURERS MODEL ACT (#312)* TO INCORPORATE FRATERNAL BENEFIT SOCIETIES

1. Project Description

To add fraternal benefit societies to the life sections of the *Risk-Based Capital for Insurers Model Act*. (#312). The request was developed based upon the need for regulatory authority to take corrective actions as a result of a fraternal society having less than the minimum amount of capital as calculated by the fraternal RBC formula.

2. Group Responsible for Drafting Model and States Participating

The Capital Adequacy (E) Task Force was responsible for drafting the revisions of the model. James J. Wrynn represented by Lou Felice (NY) chairs the Task Force. Ted Nickel represented by Peter Medley (WI) is the vice chair of the Task Force. The following states are Task Force members: Alabama, California, Connecticut, District of Columbia, Delaware, Florida, Illinois, Iowa, Kansas, Maine, Minnesota, New Mexico, Ohio, Oklahoma, Pennsylvania, South Carolina, Utah and Washington.

3. Charge Authorizing Project

A Sept. 17, 2009, referral letter from the NAIC president on behalf of the NAIC officers was received by the Capital Adequacy (E) Task Force suggesting that “the Capital Adequacy Task Force consider development of a new risk-based capital model law for fraternal benefit societies.”

4. A General Description of Drafting Process and Due Process

A request for a new model law development was adopted by the Executive (EX) Committee at the 2009 Winter National Meeting. Discussions were held by the Task Force over the next several national meetings regarding the need for a fraternal RBC model act.

At the 2011 Spring National Meeting, the Task Force requested changing the current *Risk-Based Capital for Insurers Model Act* (#312) rather than developing a new model. This request was subsequently adopted by the Financial Condition (E) Committee and Executive (EX) Committee at the 2011 Spring National Meeting.

NAIC staff were asked to draft a proposal to add fraternal benefit societies to the existing model act. The fraternal proposal was released for comment for a 30-day period at a July 14, 2011, Task Force conference call. No comment letters were received during the comment period. The Task Force unanimously adopted the draft fraternal changes to the model act at the Sept. 14, 2011, conference call. The fraternal changes to the model act were then adopted at the Financial Condition (E) Committee’s Sept. 19 meeting.

5. Significant Issues Raised

A concern was raised about whether the change to add fraternal benefit societies would become an accreditation standard. The Task Force will recommend to the Financial Regulation Standards and Accreditation (F) Committee that the changes to add fraternal benefit societies to the model act would not become an accreditation standard at this point in time.

An issue was raised regarding whether the RBC trend test would also apply to fraternal RBC. The model act draft was modified to incorporate the same trend test language and level as used for life.

REQUEST FOR MODEL LAW DEVELOPMENT

LIFE TREND TEST

This form is intended to gather information to support the development of a new model law or amendment to an existing model law. Prior to development of a new or amended model law, approval of the respective Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for model law development. Please complete all questions and provide as much detail as necessary to help in this determination.

Please circle whether this is _____ New Model Law ___X___ **Amendment to Existing Model**

1. Name of group to be responsible for drafting the model:

Capital Adequacy (E) Task Force

2. NAIC staff support contact information:

Dan Swanson
816-783-8412
dswanson@naic.org

3. Please provide a description and proposed title of the new model law. If an existing law, please provide the title, attach a current version to this form and reference the section(s) proposed to be amended.

Risk-Based Capital (RBC) for Insurers Model Act (#312). Proposed change to Section 3. A. (1) (b) to change the life trend test trigger from 2.5 to 3.0 to make it consistent with other business types.

4. Does the model law meet the Model Law Criteria? Yes or No (Circle one)
(If answering no to any of these questions, please reevaluate charge and proceed accordingly to address issues).

a. Does the subject of the model law necessitate a national standard and require uniformity amongst all states? Yes or No (Circle one)

If yes, please explain why: The model act gives states the regulatory authority to take corrective, rehabilitation or liquidation actions as a result of the insurer having less than the minimum capital amount as calculated by the risk-based capital formula. Implementing this model improves the authority states have to take action when an insurer experiences financial difficulties.

b. Does Committee believe NAIC members should devote significant regulator and Association resources to educate, communicate and support this model law? Yes or No (Circle one)

5. What is the likelihood that your Committee will be able to draft and adopt the model law within one year from the date of Executive Committee approval?

1 2 3 4 5 (Circle one)

High Likelihood

Low Likelihood

Explanation, if necessary:

6. What is the likelihood that a minimum two-thirds majority of NAIC members would ultimately vote to adopt the proposed model law?

1 2 3 4 5 (Circle one)

High Likelihood

Low Likelihood

Explanation, if necessary:

7. What is the likelihood that state legislature will adopt the model law in a uniform manner within three years of adoption by the NAIC?

1 2 3 4 5 (Circle one)

High Likelihood

Low Likelihood

Explanation, if necessary:

8. Is this model law referenced in the Accreditation Standards? Yes. If so, does the standard require the model law to be adopted in a substantially similar manner? Yes.

9. Is this model law in response to or impacted by federal laws or regulations? If yes, please explain. No.

Draft: 7/14/11

Revisions to Model 312 to change the life trend test trigger from 2.5 to 3.0.

Released for comment at a July 14, 2011 conference call by the Capital Adequacy (E) Task Force.

Underlining and overstrikes show the changes from the existing model. Comments are being requested on this draft.

Comments should be submitted by email only by Monday, Aug. 15, 2011, to Dan Swanson at dswanson@naic.org.

RISK-BASED CAPITAL (RBC) FOR INSURERS MODEL ACT

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 Section 15. Effective Date



Detail Eliminated To Conserve Space

Section 3. Company Action Level Event

- A. “Company Action Level Event” means any of the following events:
 - (1) The filing of an RBC Report by an insurer which indicates that:
 - (a) The insurer’s total adjusted capital is greater than or equal to its Regulatory Action Level RBC but less than its Company Action Level RBC;
 - (b) If a life and/or health insurer, the insurer has total adjusted capital which is greater than or equal to its Company Action Level RBC but less than the product of its Authorized Control Level RBC and ~~3.0~~^{2.5} and has a negative trend; or
 - (c) If a property and casualty insurer, the insurer has total adjusted capital which is greater than or equal to its Company Action Level RBC but less than the product of its Authorized Control Level RBC and 3.0 and triggers the trend test determined in accordance with the trend test calculation included in the Property and Casualty RBC instructions;



Detail Eliminated To Conserve Space

Legislative History (all references are to the Proceedings of the NAIC).

*1993 Proc. I 8, 137, 275-276, 556-557, 559-565, (adopted model applying only to life and health insurers).
1993 Proc. 4th Quarter 16, 20, 163, 390-398 (amended to include property and casualty insurers and reprinted).
1994 Proc. 3rd Quarter 14, 58, 264, 316, 347-356 (amended and reprinted).
1999 Proc. 4th Quarter 15, 364, 369, 375-376 (amended).
2006 Proc. 1st Quarter 36, 44-52 (amended).*

PROJECT HISTORY

CHANGES TO THE *RISK-BASED CAPITAL FOR INSURERS MODEL ACT (#312)* TO CHANGE THE LIFE RBC TREND TEST LEVEL

1. Project Description

To change the trend test level for the *Risk-Based Capital for Insurers Model Act* (#312). The request was developed to change the level where the Life RBC trend test is triggered to be raised from 2.5 of the authorized control level amount to 3.0. This would change the level to be the same level as that used for the property and casualty RBC and health RBC trend tests.

2. Group Responsible for Drafting Model and States Participating

The Capital Adequacy (E) Task Force was responsible for drafting the revisions of the model. James J. Wrynn represented by Lou Felice (NY) chairs the Task Force. Ted Nickel represented by Peter Medley (WI) is the vice chair of the Task Force. The following states are Task Force members: Alabama, California, Connecticut, District of Columbia, Delaware, Florida, Illinois, Iowa, Kansas, Maine, Minnesota, New Mexico, Ohio, Oklahoma, Pennsylvania, South Carolina, Utah and Washington.

3. Charge Authorizing Project

A March 27, 2007, letter from Steve Johnson (PA) was received by the Capital Adequacy (E) Task Force that suggested: "Raising the trigger for the Life RBC Trend Test from 250 to 300. This change would be consistent with the Property/Casualty Trend Test and would result in more effective efforts to correct negative trends before they create a solvency concern." The item was added to the Task Force's working agenda assigned to the Life Risk-Based Capital (E) Working Group.

4. A General Description of Drafting Process and Due Process

At the 2008 Fall National Meeting, the Life Risk-Based Capital (E) Working Group reviewed year-end 2003 to 2007 data of additional companies that would be triggered by the change in the trend test level. The Capital Adequacy (E) Task Force decided to keep the issue on the working agenda in order to review data for companies that would have triggered the trend test during the 2008 financial crisis. The Working Group reviewed data for year-end 2005 through 2009 at the 2010 Fall National Meeting. The Working Group recommendation was to consider this change when another change was being made to the model act.

At the 2010 Fall National Meeting, with one state objecting, the Task Force decided to release for a comment period of 30 days a draft model law request form to change the life trend test level. One comment letter was received and discussed on a Dec. 13, 2010, Task Force conference call, where the model law request was adopted with four states opposing the motion. The model law request form was then adopted by the Financial Condition (E) Committee. The request to amend the model law was adopted by the Executive (EX) Committee at the 2011 Spring National Meeting.

The trend test change to the model act was released for comment for a 30-day period at a July 14, 2011, Task Force conference call. No comment letters were received during the comment period. The Task Force unanimously adopted the life trend test change to the model act on the Sept. 14, 2011, conference call. The life trend test changes to the model act were then adopted at the Financial Condition (E) Committee's Sept. 19 meeting.

5. Significant Issues Raised

The Life Risk-Based Capital (E) Working Group had a concern about whether the relatively small number of additional companies that would trigger the trend test would justify changing the model act for just this item. The Capital Adequacy (E) Task Force later decided to make changes to the model for fraternal benefit societies in addition to the trend test change.

A Nov. 29, 2010, comment letter from the American Council of Life Insurers (ACLI) requested further analysis of the need for and the impact of the proposed change. Regulator-only reports of the companies that would have been affected for year-end 2005 to 2009 were distributed to the Task Force. The ACLI eventually agreed to not oppose implementation of the change.

Statement of Statutory Accounting Principles No. 101

Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10

STATUS

Type of Issue:	Common Area
Issued:	August 31, 2011
Effective Date:	January 1, 2012
Affects:	Supersedes SSAP No. 10R and SSAP No. 10
Affected by:	No other pronouncements
Interpreted by:	INT 99-00, INT 00-21, INT 00-22, INT 01-18, INT 01-19, INT 01-20, INT 04-17, INT 06-12

STATUS	1
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Income Taxes

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. This statement supersedes conclusions reached in *SSAP No. 10—Income Taxes* and *SSAP No. 10R—Income Taxes, A Temporary Replacement of SSAP No. 10*.

SUMMARY CONCLUSION

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109) with modifications for state income taxes, the realization criteria for deferred tax assets, and the recording of the impact of changes in deferred tax balances. One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations. For purposes of this statement, only adjusted gross deferred tax assets that are more likely than not (a likelihood of more than 50 percent) to be realized shall be considered in determining admitted adjusted gross deferred tax assets.

Current Income Taxes

3. "Income taxes incurred" shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (recoverable) for the current year. Current income taxes are defined as:

- a. Current year estimates (including quarterly estimates) of federal and foreign income taxes payable or refundable, based on tax returns for the current and prior years, except as addressed in paragraph 3.b., and tax loss contingencies (including related interest and penalties) for current and all prior years, computed in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R) with the following modifications:
 - i. The term "probable" as used in SSAP No. 5R shall be replaced by the term "more likely than not (a likelihood of more than 50 percent)" for federal and foreign income tax loss contingencies only.
 - ii. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.

SSAP No. 101

Statement of Statutory Accounting Principles

- iii. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.
 - b. Amounts incurred or received during the current year relating to prior periods, to the extent not previously provided, as such amounts are deemed to be changes in accounting estimates as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3).
 - c. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to “gross-up” its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity’s (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.
4. State taxes (including premium, income and franchise taxes) shall be computed in accordance with SSAP No. 5R and shall be limited to (a) taxes due as a result of the current year’s taxable basis calculated in accordance with state laws and regulations and (b) amounts incurred or received during the current year relating to prior periods, to the extent not previously provided as such amounts are deemed to be changes in accounting estimates. Property and casualty insurance companies shall report state taxes as other underwriting expenses under the caption “Taxes, licenses, and fees.” Life and accident and health insurance companies shall report such amounts as general expenses under the caption “Insurance taxes, licenses, and fees, excluding federal income taxes.” Other health entities shall report such amounts as general administration expenses under the caption “Taxes, licenses, and fees.” State tax recoverables that are reasonably expected to be recovered in a subsequent accounting period are admitted assets. State taxes are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, or items for which the reporting entity has authority to recover under a state regulation or statute.

Deferred Income Taxes

5. Because tax laws and statutory accounting principles differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains, and losses, differences arise between:
 - a. The amount of taxable income and pretax statutory financial income for a year, and
 - b. The tax bases of assets or liabilities and their reported amounts in statutory financial statements.

Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10

SSAP No. 101

6. A reporting entity's balance sheet shall include deferred income tax assets (DTAs) and liabilities (DTLs) related to the estimated future tax consequences of temporary differences and carryforwards, generated by statutory accounting, as defined in paragraph 11 of FAS 109.
7. A reporting entity's deferred tax assets and liabilities are computed as follows:
 - a. Temporary differences are identified and measured using a "balance sheet" approach whereby statutory and tax basis balance sheets are compared;
 - b. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased;
 - c. Total DTAs and DTLs are computed using enacted tax rates;
 - d. A DTL is not recognized for amounts described in paragraph 31 of FAS 109; and
 - e. Gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment¹, determined in a manner consistent with paragraphs 20 through 25 of FAS 109², shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).

¹ The statutory valuation allowance adjustment is utilized strictly to calculate the "adjusted gross DTA". (Admittance criteria in paragraph 11 are applied to the "adjusted gross DTA".) In determining the amount of adjusted gross DTA, the reporting entity shall consider reversal patterns of temporary differences to the extent necessary to support establishing or not establishing a valuation allowance adjustment, determined in accordance with paragraphs 228 and 229 of FAS 109. For purposes of this accounting statement, consideration of reversal patterns does not require scheduling beyond that necessary to support establishing or not establishing a valuation allowance adjustment. The application of the statutory valuation allowance adjustment in this statement shall not result in a statutory valuation allowance reserve within the statutory financial statements, but rather should result in a reduction of the gross DTA.

² For purposes of determining the amount of adjusted gross DTA and the amount admitted under paragraph 11, the admission calculation shall be made on a separate company, reporting entity basis. A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocated to it) as a separate legal entity in determining the admitted DTA under paragraph 11.a. Furthermore, the DTA under this paragraph may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent. The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement. The amount of admitted adjusted gross DTA under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable realization period, on a separate company basis. The reporting entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the

8. Changes in DTAs and DTLs, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of gains and losses in unassigned funds (surplus). Admitted adjusted gross DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position.

Admissibility of Income Tax Assets

9. Current income tax recoverables shall include all current income taxes, including interest, reasonably expected to be recovered in a subsequent accounting period, whether or not a return or claim has been filed with the taxing authorities. Current income tax recoverables are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, as defined in paragraph 289 of FAS 109, or items for which the reporting entity has substantial authority, as that term is defined in Federal Income Tax Regulations.

10. Current income tax recoverables meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

11. The net admitted DTA shall not exceed the excess of the adjusted gross DTA, as determined under paragraph 7.e., over gross DTL. Adjusted gross DTAs shall be admitted based upon the three-component admission calculation at an amount equal to the sum of paragraphs 11.a., 11.b., and 11.c.:

- a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, including any amounts established in accordance with the provision of SSAP No. 5R as described in paragraph 3.a. of this statement related to those periods.
- b. If the reporting entity is subject to risk-based capital requirements or is required to file a Risk-Based Capital Report with the domiciliary state, the reporting entity shall use the *Realization Threshold Limitation Table – RBC Reporting Entities* (RBC Reporting Entity Table) in this component of the admission calculation. The RBC Reporting Entity Table's threshold limitations are contingent upon the ExDTA RBC ACL Ratio³.

If the reporting entity is either a mortgage guaranty insurer or financial guaranty insurer that is not subject to risk-based capital requirements and is not required to file a Risk-

applicable realization period cannot admit a DTA related to the loss under paragraph 11.b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.

³ The December 31 Risk-Based Capital ratio is calculated based on the Authorized Control Level RBC filed with the state of domicile and computed without net deferred tax assets (ExDTA ACL RBC). The interim period (March 31, June 30, and September 30) ExDTA ACL RBC ratio numerator shall use the Total Adjusted Capital (TAC) with current quarter surplus ExDTA and current quarter TAC adjustments. The denominator shall use the Authorized Control Level RBC as filed for the most recent calendar year.

Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10

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Based Capital Report with the domiciliary state and the reporting entity meets the minimum capital and reserve requirements for the state of domicile, then the reporting entity shall use the *Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities* (Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table) in this component of the admission calculation. The Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table's threshold limitations are contingent upon the ratio of surplus without admitted DTA (ExDTA Surplus) to policyholders and contingency reserves⁴.

If the reporting entity (1) is not subject to risk-based capital requirements, (2) is not required to file a Risk-Based Capital Report with the domiciliary state, (3) is not a mortgage guaranty or financial guaranty insurer, and (4) meets the minimum capital and reserve requirements, then the reporting entity shall use the *Realization Threshold Limitation Table – Other Non-RBC Reporting Entities* (Other Non-RBC Reporting Entity Table). The Other Non-RBC Reporting Entity Table's threshold limitations are contingent upon the ratio of adjusted gross DTA (Adjusted gross DTA less the amount of DTA admitted in paragraph 11.a.) to adjusted capital and surplus⁵.

⁴ If the reporting entity is a mortgage guaranty insurer, this ratio is based on the requirements of Section 12 of the NAIC Mortgage Guaranty Insurance Model Law and state laws that require aggregate capital to be maintained based on the risk characteristics and amount of insurance in force. If the reporting entity is a financial guaranty insurer, this ratio is based on the requirements of Section 4C of the NAIC Financial Guaranty Insurance Model Law and state laws that require aggregate capital to be maintained based on the risk characteristics and amount of insurance in force.

⁵ Consistent with the requirements of paragraph 11.b.ii., adjusted statutory capital and surplus used in this calculation component is based on statutory capital and surplus for the current reporting period excluding any net DTA, EDP equipment and operating system software and any net positive goodwill.

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Realization Threshold Limitation Table – RBC Reporting Entities

ExDTA ACL RBC (%)	11.b.i.	11.b.ii.
Greater than 300%	3 years	15%
200 – 300%	1 year	10%
Less than 200%	0 years	0%

Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities

Ex DTA Surplus/Policyholders and Contingency Reserves (%)	11.b.i.	11.b.ii.
Greater than 115%	3 years	15%
100% to 115%	1 year	10%
Less than 100%	0 years	0%

Realization Threshold Limitation Table – Other Non-RBC Reporting Entities

Adjusted Gross DTA / Adjusted Capital & Surplus (%)	11.b.i.	11.b.ii.
Less than 50%	3 years	15%
50% to 75%	1 year	10%
Greater than 75%	0 years	0%

The reporting entity shall admit:

- i. The amount of adjusted gross DTAs, after the application of paragraph 11.a., expected to be realized within the applicable period (refer to the 11.b.i. column of the applicable Realization Threshold Limitation Table above; the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) following the balance sheet date limited to the amount determined in paragraph 11.b.ii.

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- ii. An amount that is no greater than the applicable percentage (refer to the 11.b.ii. column of the applicable Realization Threshold Limitation Table above: the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for the current reporting period's statement filed with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.
 - c. The amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs. The reporting entity shall consider the character (i.e., ordinary versus capital) of the DTAs and DTLs such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. Additionally, for purposes of this component, the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in paragraph 7.e.
12. In computing a reporting entity's admitted adjusted gross DTA pursuant to paragraph 11;
- a. For purposes of paragraph 11.a., existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, shall be determined in accordance with paragraphs 228 and 229 of FAS 109;
 - b. In determining the amount of federal income taxes that can be recovered through loss carrybacks, the amount and character (i.e., ordinary versus capital) of the loss carrybacks and the impact, if any, of the Alternative Minimum Tax shall be determined in accordance with the provisions of the Internal Revenue Code, and regulations thereunder;
 - c. The amount of carryback potential that may be considered in calculating the admitted adjusted gross DTAs of a reporting entity in subparagraph 11.a. above, that files a consolidated income tax return with one or more affiliates, may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent; and
 - d. The phrases "reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years," "realized within one year of the balance sheet date" and "realized within three years of the balance sheet date" are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

Realization of Tax Benefits and Tax-Planning Strategies

13. Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law. The following four possible sources of taxable income may be available under the tax law to realize a tax benefit for deductible temporary differences and carryforwards:

- a. Future reversals of existing taxable temporary differences

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- b. Future taxable income exclusive of reversing temporary differences and carryforwards
- c. Taxable income in prior carryback year(s) if carryback is permitted under the tax law
- d. Tax-planning strategies in paragraph 14 that would, if necessary, be implemented to, for example:
 - i. Accelerate taxable amounts to utilize expiring carryforwards
 - ii. Change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss
 - iii. Switch from tax-exempt to taxable investments.

Evidence available about each of those possible sources of taxable income will vary for different tax jurisdictions and, and possibly, from year to year. To the extent evidence about one or more sources of taxable income is sufficient to support a conclusion that the reporting entity will realize the full or a partial amount of its adjusted gross deferred tax assets, other sources need not be considered. Consideration of each source is required, however, to determine the amount of the statutory valuation allowance adjustment that is recognized for gross deferred tax assets under paragraph 7.e.

14. In some circumstances, there are tax-planning strategies (including elections for tax purposes) that (a) are prudent and feasible, (b) a reporting entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. A reporting entity shall consider tax-planning strategies in (1) determining the amount of the statutory valuation allowance adjustment necessary under paragraph 7.e. and (2) the realization of deferred tax assets when determining admission under paragraph 11. Any significant potential expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall reduce the amount of admission under paragraph 11.

15. When a prudent and feasible tax-planning strategy is contemplated, and management determines this strategy would more likely than not enable the reporting entity to realize the full or a partial amount of its adjusted gross deferred tax assets, paragraph 3 of this statement related to tax loss contingencies shall be applied in determining admissibility of deferred tax assets under paragraph 11 of this statement.

Intercompany Income Tax Transactions

16. In the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions (including payment of tax contingencies to its parent) between the affiliated parties shall be recognized if:

- a. Such transactions are economic transactions as defined in *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25);
- b. Are pursuant to a written income tax allocation agreement; and

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- c. Income taxes incurred are accounted for in a manner consistent with the principles of FAS 109, as modified by this statement.

17. Amounts owed to a reporting entity pursuant to a recognized transaction shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity's parent, within 90 days of the receipt of such refund.

Intraperiod Tax Allocation

18. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

19. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109. Furthermore, income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with SSAP No. 3 unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate.

Interim Periods

20. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of *Accounting Principles Board Opinion No. 28, Interim Financial Reporting*. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If a reporting entity is unable to estimate a part of its "ordinary" income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

Disclosures

21. Statutory financial statement disclosures shall be made in a manner consistent with the provisions of paragraphs 43—45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity's GAAP valuation allowance shall be replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmittance of some portion or all of a reporting entity's DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 22 to 28 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

22. The components of the net DTA or DTL recognized in a reporting entity's financial statements shall be disclosed as follows:

- a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;

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- b. The total of all DTLs by tax character;
 - c. The total DTAs nonadmitted as the result of the application of paragraph 11;
 - d. The net change during the year in the total DTAs nonadmitted;
 - e. The amount of each result or component of the calculation, by tax character of paragraphs 11.a., 11.b.i., 11.b.ii., and 11.c. (see Q&A 4.14 of SSAP No. 101 as an example) and the ExDTA ACL RBC Ratio, the ExDTA Surplus/Policyholders and Contingency Reserves Ratio, or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable *Realization Threshold Limitation Table* (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable; and
 - f. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character, and whether the tax-planning strategies include the use of reinsurance-related tax planning strategies.
23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:
- a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;
 - b. The cumulative amount of each type of temporary difference;
 - c. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and
 - d. The amount of the DTL for temporary differences other than those in item c. above that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.
24. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:
- a. Current tax expense or benefit;
 - b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);
 - c. Investment tax credits;
 - d. The benefits of operating loss carryforwards;

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- e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity; and
 - f. Adjustments to gross deferred tax assets because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset, and the reason for the adjustment and change in judgment.
25. Additionally, to the extent that the sum of a reporting entity's income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.
26. A reporting entity shall also disclose the following:
- a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;
 - b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and
 - c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.
27. For any federal or foreign income tax loss contingencies as determined in accordance with paragraph 3.a. for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, the reporting entity shall disclose an estimate of the range of the reasonably possible increase or a statement that an estimate of the range cannot be made.
28. If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:
- a. A list of names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and
 - b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, give an explanation of why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.
29. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

30. This statement adopts the provisions of FAS 109 except as modified in paragraph 2 of this statement which results in paragraphs 29—30, 36—37, 39, 41—42, 46, and 49—59 of FAS 109 being

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rejected, inasmuch as they are not applicable to reporting entities subject to this statement or are inconsistent with other statutory accounting principles. Paragraph 47 of FAS 109 is adopted with modification to provide for the disclosures required for non public reporting entities.

31. This statement rejects *FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods...an interpretation of APB Opinion No. 28 and FIN 48: Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109.*

32. The following lists Accounting Principles Board Opinions that are adopted or rejected by this statement:

- a. *Accounting Principles Board Opinion No. 2, Accounting for the "Investment Credit,"* paragraphs 9—15 are adopted with modification to utilize the cost reduction method only and rejects all other paragraphs;
- b. *Accounting Principles Board Opinion No. 4 (Amending No. 2), Accounting for the "Investment Credit,"* is rejected in its entirety;
- c. *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966,* paragraph 6 is adopted;
- d. *Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas,* paragraphs 1—3, 5—9, 12—13, and 15—18 are adopted, and paragraphs 19—25, and 31—33 are rejected;
- e. *Accounting Principles Board Opinion No. 28, Interim Financial Reporting,* paragraphs 19 and 20 are adopted and all other paragraphs rejected.

33. The following lists FASB Technical Bulletins that are adopted or rejected by this statement:

- a. *FASB Technical Bulletin No. 79-9, Accounting in Interim Periods for Changes in Income Tax Rates* is rejected in its entirety;
- b. *FASB Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases* is adopted in its entirety.

34. The following lists FASB Emerging Issues Task Force Issues that are adopted or rejected by this statement:

- a. *FASB Emerging Issues Task Force No. 91-8, Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax,* is rejected in its entirety;
- b. *FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary,* is adopted in its entirety;

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- c. *FASB Emerging Issues Task Force No. 93-13, Effect of a Retroactive Change in Enacted Tax Rates That Is Included in Income from Continuing Operations*, is rejected in its entirety;
- d. *FASB Emerging Issues Task Force No. 93-16, Application of FASB Statement No. 109 to Basis Differences within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion No. 23*, is rejected in its entirety;
- e. *FASB Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation*, is adopted in its entirety;
- f. *FASB Emerging Issues Task Force No. 94-10, Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109*, is rejected in its entirety;
- g. *FASB Emerging Issues Task Force No. 95-9, Accounting for Tax Effects of Dividends in France in Accordance with FASB Statement No. 109*, is rejected in its entirety;
- h. *FASB Emerging Issues Task Force No. 95-10, Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*, is rejected in its entirety;
- i. *FASB Emerging Issues Task Force No. 95-20, Measurement in the Consolidated Financial Statements of a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments*, is rejected in its entirety.

35. This statement rejects *AICPA Accounting Interpretations, Accounting for the Investment Credit: Accounting Interpretations of APB Opinion No. 4* in its entirety.

Effective Date and Transition

36. This statement shall be effective for years beginning January 1, 2012. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

DRAFTING NOTE; Appendix A – Implementation Questions and Answers will be updated to reflect the guidance included in this statement.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

FASB Statement No. 109, Accounting for Income Taxes

Accounting Principles Board Opinion No. 2, Accounting for the “Investment Credit”

Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966, paragraph 6

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Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas, paragraphs 1—3, 5—9, 12—13, and 15—18

Accounting Principles Board Opinion No. 28, Interim Financial Reporting, paragraphs 19 and 20

FASB Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases

FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary

FASB Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation

RELEVANT ISSUE PAPERS

Issue Paper No. 83—Accounting for Income Taxes

DRAFTING NOTE: An issue paper will be developed to document conclusions reached in this statement.

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Adopted by the Financial Condition (E) Committee Sept. 19, 2011

GUIDELINE FOR IMPLEMENTATION
OF STATE ORDERLY LIQUIDATION AUTHORITY

Drafting Note: Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 provides for the orderly liquidation of certain financial companies, including qualifying insurance companies, with the Federal Deposit Insurance Corporation (FDIC) generally seeking the appointment as receiver. However, in the case of qualifying insurance companies, the liquidation or rehabilitation of such a financial company will be conducted as provided under state law pursuant to 12 U.S.C. § 5383(e). If at the end of the 60-day period provided for under 12 U.S.C. § 5383(e)(3) the commissioner (or other appropriate regulatory agency) has not filed the appropriate state judicial action to place the insurer into orderly liquidation, the FDIC shall have the authority to stand in the place of the commissioner and file the appropriate judicial action in the appropriate state court to place the insurer into orderly liquidation under the laws and requirements of the state. The following statutory language is not an amendment to the NAIC receivership models, but is intended as a Guideline for use by those states seeking to review their authority under existing state law for purposes of initiating rehabilitation or liquidation proceedings in accordance with the federal statute:

[] Orderly Liquidation Authority

In accordance with Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 with respect to an insurance company that is a covered financial company, as that term is defined under 12 U.S.C. § 5381:

- A. The commissioner may file in the [insert proper court] court of this state a petition for an order of rehabilitation or liquidation on any of the following grounds:
- 1) Upon a determination and notification given by the Secretary of Treasury (in consultation with the President) that the insurance company is a financial company satisfying the requirements of 12 U.S.C. § 5383(b), and the board of directors (or body performing similar functions) of the insurance company acquiesces or consents to the appointment of a receiver pursuant to 12 U.S.C. § 5382(a)(1)(A)(i), with such consent to be considered as consent to an order of rehabilitation or liquidation; or
 - 2) Upon an order of the United States District Court for the District of Columbia under 12 U.S.C. § 5382(a)(1)(A)(iv)(I) granting the petition of the Secretary of the Treasury concerning the insurance company under 12 U.S.C. § 5382(a)(1)(A)(i); or
 - 3) A petition by the Secretary of the Treasury concerning the insurance company is granted by operation of law under 12 U.S.C. § 5382(a)(1)(A)(v).
- B. Notwithstanding any other provision in this Act or other law, after notice to the insurance company, the receivership court may grant a petition for rehabilitation or liquidation within 24 hours of the filing of a petition pursuant to this section.
- C. If the court does not make a determination on the petition for rehabilitation or liquidation filed pursuant to this section within 24 hours after the filing of the petition, it shall be deemed granted by operation of law upon the expiration of the 24 hour period. At the time that an order is deemed granted under this section, the provisions of [cite to applicable state law addressing rehabilitation or liquidation] shall be deemed to be in effect, and the receiver shall be deemed to be appointed [optional: affirmed] and have all of the applicable powers provided by [refer to applicable state law addressing rehabilitation or liquidation], regardless of whether an order has been entered. The receivership court shall expeditiously enter an order of rehabilitation or liquidation that:
- 1) Is effective as of date that it is deemed granted by operation of law; and
 - 2) Conforms to [cite to applicable state law addressing rehabilitation or liquidation], as applicable.

- D. Any order of rehabilitation or liquidation made pursuant to this section shall not be subject to any stay or injunction pending appeal.
- E. Nothing in this section shall be construed to supersede or impair any other power or authority of the commissioner or state courts under this Act.

PROJECT HISTORY

MODEL GUIDELINE FOR IMPLEMENTATION OF STATE ORDERLY LIQUIDATION AUTHORITY

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

Following passage of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in 2010, the Receivership and Insolvency (E) Task force realized the need for a comprehensive review of how the state-based receivership community would respond in the event of a federal determination of systemic risk involving an insurance company or affiliate of an insurance. Specifically, Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 provides for the orderly liquidation of certain financial companies, including qualifying insurance companies, with the Federal Deposit Insurance Corporation (FDIC) generally seeking the appointment as receiver. However, in the case of qualifying insurance companies, the liquidation or rehabilitation of such a financial company will be conducted as provided under state law pursuant to 12 U.S.C. § 5383(e). If at the end of the 60-day period provided for under 12 U.S.C. § 5383(e)(3) the commissioner has not filed the appropriate state judicial action to place the insurer into orderly liquidation, the FDIC shall have the authority to stand in the place of the commissioner and file the appropriate judicial action in the appropriate state court to place the insurer into orderly liquidation under the laws and requirements of the state. The new model guideline statutory language is not an amendment to the NAIC receivership models, but is intended as a Guideline for use by those states seeking to review their authority under existing state law for purposes of initiating rehabilitation or liquidation proceedings in accordance with the federal statute.

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

The Dodd-Frank Receivership Implementation (E) Working Group was formed by the Task Force to address this issue. The states participating were Illinois, California, Connecticut, Florida, Iowa, Indiana, Louisiana, Ohio, Pennsylvania, and Texas.

The Working Group members consisted of: Patrick Hughes (IL), Harry Levine and David Wilson (CA), Jon Arsenault (CT), Wayne Johnson and Sha'ron James (FL), Jim Mumford (IA), Kevin Baldwin (IL), Cindy Donovan (IN), Arlene Knighten (LA), Kristen Brown and Lynda Loomis (OH), Laura Lyon-Slaymaker (PA), and James Kennedy (TX).

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

The charge was delegated from the Task Force to the Dodd-Frank Receivership Implementation (E) Working Group. The charge was as follows: Review and consider portions of the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act to determine what, if any state laws, regulations or procedures are necessary for state receivers and the NAIC to be prepared for its requirements related to receivership activities, as well as, monitor, review and provide input on federal rulemaking and studies related to insurance receivership.

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

The Dodd-Frank Receivership Implementation (E) Working Group formed a Legal Issues Drafting Group that was tasked with drafting an NAIC model guideline to help some states better prepare for a Title II event. The Subgroup consisted of the following members: Kevin Baldwin (IL), Arlene Knighten (LA), Kristen Brown and Lynda Loomis (OH), and James Kennedy (TX). The drafting group met via regulator to regulator conference call on four separate occasions in 2011, spending considerable time deliberating the receivership implementation issues.

In January 2011, the Legal Issues Drafting Group drafted a document titled Preliminary Outline Of Legal Items For Consideration By The Dodd-Frank Receivership Implementation (E) Working Group.

4. A General Description of the Drafting Process and Due Process (cont.)

On February 4, 2011, the Working Group met via conference call with interested parties and regulators. During the call Kevin Baldwin provided an update from the Legal Issues Drafting Group. The update discussed the legal issues outline which identified potential concerns with state laws and regulations in the event of a Dodd-Frank receivership. Also, the legal issues outline proposed the Working Group seek the authority to develop an NAIC model guideline that states could use, as opposed to a model law or regulation. The Working Group exposed the outline for public comment for a period of 19 days with a comment deadline of Wednesday, February 23, 2011.

The Working Group met at the NAIC Spring National Meeting on March 27, 2011. At the meeting, Mr. Hughes directed the Working Group to receive and discuss comments relating to the public exposure. Florida made a motion to receive the edits that were distributed and to approve the preliminary outline. California seconded the motion and it passed.

The Working Group held a conference call on June 3, 2011. During the call, Mr. Baldwin discussed that the intention of the model guideline is to provide guidance and serve as a template for potential state law drafting revisions. Mr. Baldwin discussed that individual states might want to review existing state law to ensure appropriate authority is available in the event of a Dodd-Frank Act determination with a domestic insurer. The guideline provides that any of the triggers for a Dodd-Frank Act receivership constitute an automatic ground for receivership under state law. It also provides for some timing and procedural rules that would work to effectively implement the state-based receivership in the rapid order that is called for under the Dodd-Frank Act. Mr. Baldwin stated that the guideline is included for the states to utilize, to the extent that they feel necessary, when changes need to be made to existing state laws. The document was once again exposed for public comment.

The Working Group held a conference call on August 1, 2011. The purpose of the call was to discuss comments received from the June 3 public exposure of the model guideline.

Following the Aug. 1 conference call, the document was revised and exposed for public comment on Aug. 8, with comments due by the close-of-business Aug.12. No comments were received within the deadline period.

The Working Group held a conference call on Aug. 16. A motion was proposed and accepted to send model guideline to the Receivership and Insolvency (E) Task Force (RITF). The Receivership & Insolvency Task Force adopted on August 30, 2011.

6. A Discussion of the Significant Issues

The following significant issue was discussed with regard to this model guideline.

Denied Commissioner Petition

Interested parties commented that there was ambiguity in the model guideline relating to circumstances where a state court has denied the commissioner's petition. The Working Group adjusted the preamble of the model guideline to provide clarity on the issue.

7. Any Other Important Information

None.

**REQUEST FOR MODEL LAW DEVELOPMENT
CREDIT FOR REINSURANCE MODEL LAW (#785)**

This form is intended to gather information to support the development of a new model law or amendment to an existing model law. Prior to development of a new or amended model law, approval of the respective Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for model law development. Please complete all questions and provide as much detail as necessary to help in this determination.

Please check whether this is: New Model Law or Amendment to Existing Model

1. Name of group to be responsible for drafting the model:

Reinsurance (E) Task Force

2. NAIC staff support contact information:

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3. Please provide a description and proposed title of the new model law. If an existing law, please provide the title, attach a current version to this form and reference the section(s) proposed to be amended.

Credit for Reinsurance Model Law (Model #785) (copy attached)

Sections Proposed to be Amended: Section 2(D)(3) would be amended to allow the commissioner with principal regulatory oversight of the trust the discretion to reduce the minimum trustee surplus requirement for a multiple-beneficiary trust fund maintained by an assuming insurer in run-off.

Please note that the Reinsurance Task Force is submitting a corresponding request to make identical amendments to the Credit for Reinsurance Model Regulation (Model #786).

UPDATE: The Reinsurance Task Force will also begin discussions on amending Model #785 to incorporate key elements of the Reinsurance Regulatory Modernization Framework Proposal, which was previously adopted by the NAIC at the Winter 2008 National Meeting. The Task Force previously approved a resolution for NAIC staff to initiate the model law process with respect to these changes at the Summer 2009 National Meeting, and it is expected that the Task Force will confirm this request at this meeting.

4. **Does the model law meet the Model Law Criteria?** **Yes** or **No** **(Check one)**
(If answering no to any of these questions, please reevaluate charge and proceed accordingly to address issues).

a. **Does the subject of the model law necessitate a national standard and require uniformity amongst all states?** **Yes** or **No** **(Check one)**

If yes, please explain why

Model #785 provides that credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the assuming insurer meets one of the following criteria:

1. The assuming insurer is licensed in the same state of domicile as the ceding company for a like kind of business.
2. The assuming insurer is accredited by the domiciliary insurance department of the ceding company.
3. The assuming insurer is domiciled and licensed in a state with substantially similar credit for reinsurance laws as the domiciliary state of the ceding company.
4. The assuming insurer provides collateral in the form of a multiple-beneficiary trust.
5. The assuming insurer provides collateral or other security to the ceding insurer.

With respect to number (4) above, Section 2(D) of Model #785 provides the requirements for an assuming insurer that maintains a multiple-beneficiary trust for the purposes of securing reinsurance obligations to U.S. ceding companies. With respect to the required balance for such a multiple-beneficiary trust, Model #785 provides the following: "The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. domiciled insurers, and, in addition, the assuming insurer shall maintain a trustee surplus of not less than \$20,000,000."

After considering a proposal submitted by an interested party, the Reinsurance Task Force reached a consensus that the \$20 million minimum trustee surplus requirement for a multiple-beneficiary trust can become problematic with respect to solvency and liquidity for an assuming insurer that has entered into run-off. As the liabilities attributable to the U.S. trust are reduced, the percentage of total collateral in the trust becomes disproportionately high in relation to the assuming insurer's obligations to U.S. cedants. The Reinsurance Task Force has determined that under the appropriate circumstances, it is prudent for the minimum trustee surplus requirement to be reduced as the assuming insurer's obligations to U.S. cedants decrease. State laws based on (or substantially similar to) Model #785 would require amendment in order to prevent such reduction in a multiple-beneficiary trust balance from negatively impacting the policyholders' surplus of U.S. ceding companies that are taking financial statement credit for reinsurance ceded to the applicable assuming insurer.

The Task Force is proposing to amend Model #785 to allow the commissioner with principal regulatory oversight of the trust the discretion to reduce the minimum trustee surplus requirement for a multiple-beneficiary trust fund maintained by an assuming insurer in run-off. The Task Force reached a consensus that the reduction in trustee surplus would be subject to the following parameters: At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trustee surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trustee surplus may not be reduced to an amount less than (30% of 50% minimum is yet to be decided) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers.

While the proposed amendment would potentially reduce the minimum trustee surplus requirement applicable to a multiple-beneficiary trust, it should be noted that it would not alter the requirement that the trust balance cover 100% of the assuming insurer's obligations to U.S. cedants.

Model #785 is referenced in the current Accreditation Standards. It is understood that specific state law which is determined to be more conservative than the related accreditation standard is generally considered to be acceptable in meeting such standard. As the proposed amendment would result in a less conservative minimum trustee surplus requirement for a multiple-beneficiary trust than the requirement under the current standard, no U.S. jurisdiction that is accredited under the current standard would be required to adopt this proposed amendment in order to maintain its accreditation status. However, in order for the proposed amendment to be effective in practice, uniform adoption throughout all U.S. jurisdictions would be necessary. An assuming insurer providing creditable reinsurance within the U.S. pursuant to this section of Model #785 maintains a single trust account in the U.S. for the benefit of its U.S. cedants. Therefore, the single trust account would have to meet the requirements of the most conservative state laws with respect to minimum trustee surplus/minimum trust balance in order for U.S. cedants domiciled in such jurisdictions to be eligible to receive full financial statement credit for reinsurance ceded to the applicable assuming insurer.

b. Does Committee believe NAIC members should devote significant regulator and Association resources to educate, communicate and support this model law?

Yes or No (Check one)

5. What is the likelihood that your Committee will be able to draft and adopt the model law within one year from the date of Executive Committee approval?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: The Task Force contemplated possible language to address this issue during its consideration of the proposal. Based on the high degree of consensus expressed during those discussions, it is very likely that the Task Force will finalize the amendment language in a very short time frame.

6. What is the likelihood that a minimum two-thirds majority of NAIC members would ultimately vote to adopt the proposed model law?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Given the high degree of consensus among the 30 members of the Reinsurance Task Force during consideration of this proposal (no members expressed opposition in proceeding with the request for Model Law development), it is likely that a two-thirds majority of NAIC members would be in support of the proposed amendment.

7. What is the likelihood that state legislature will adopt the model law in a uniform manner within three years of adoption by the NAIC?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Ultimate adoption by state legislatures is less certain. States would not be required to adopt the proposed amendment in order to maintain NAIC accreditation, as the current accreditation standard would be considered more conservative. The degree of likelihood will probably increase in the event that state legislatures consider more extensive reinsurance collateral reforms in the near future.

8. Is this model law referenced in the Accreditation Standards? If so, does the standard require the model law to be adopted in a substantially similar manner?

Model #785 is referenced in the Accreditation Standards for Reinsurance Ceded. Section 10 reads as follows:

10. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation and the NAIC Life and Health Reinsurance Agreement Model Regulation or substantially similar laws.

9. Is this model law in response to or impacted by federal laws or regulations? If yes, please explain.

Not Applicable

Preface to Credit for Reinsurance Models

The amendments to the NAIC Credit for Reinsurance Model Law (#785) & Regulation (#786) are part of a larger effort to modernize reinsurance regulation in the United States. The NAIC initially adopted the Reinsurance Regulatory Modernization Framework Proposal during its 2008 Winter National Meeting. The NAIC recommended that this framework be implemented through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation. In addition to this proposed federal legislation, the framework also provided that changes to state insurance laws should be considered. For example, state laws to establish requirements under which states would regulate qualified reinsurers, and also to consider reinsurance risk diversification and notice requirements for ceding insurers.

On July 21, 2010, Congress passed and the President signed related federal legislation, the Nonadmitted and Reinsurance Reform Act, which became effective July 21, 2011. While this act does not implement the NAIC framework, it does preempt the extraterritorial application of state credit for reinsurance law and permits states of domicile to proceed forward with reinsurance collateral reforms on an individual basis if they are accredited. This federal legislation also does not prohibit the states from acting together, through the NAIC, to achieve the reinsurance modernization framework goals. In addition to the current work on the credit for reinsurance models, the NAIC will continue its efforts to implement other aspects of the framework. These efforts will continue both through work conducted by the Reinsurance Task Force and through referrals to the appropriate groups within the NAIC. In addition, the NAIC will consider a proposal to form a new group to provide high quality review of reinsurance collateral reduction applications and assistance to the states. Such a process with respect to the review of applications for reinsurance collateral reduction and qualified jurisdictions should strengthen state regulation and prevent regulatory arbitrage. Such an effort would be supported by NAIC staff with substantial expertise to carry out the functions of such a group.

Finally, the NAIC will continue to work on requirements for NAIC review and approval of qualified jurisdictions, and will undertake a re-examination of the collateral amounts within two years from the effective date of the revisions to the models.

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Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, ~~D~~, ~~or E~~ or F of this section. Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection ~~FG~~ have been satisfied.

- A. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is licensed to transact insurance or reinsurance in this state.

Drafting Note: A state that provides for licensing of reinsurance by line, for consistency should adopt an amended version of Subsection A requiring the assuming insurer to be “licensed to transact reinsurance in this state.”

- B. ~~(1)~~ Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is accredited by the commissioner as a reinsurer in this state. ~~And~~ In order to be eligible for accreditation, a reinsurer is one that must:
- ~~(a)~~ (1) Files with the commissioner evidence of its submission to this state’s jurisdiction;
- ~~(b)~~ (2) Submits to this state’s authority to examine its books and records;

Credit for Reinsurance Model Law

- (e3) ~~IsBe~~ licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, ~~isbe~~ entered through and licensed to transact insurance or reinsurance in at least one state;
- (e4) Files annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; and
- (5) Demonstrate to the satisfaction of the commissioner that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer is deemed to meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than \$20,000,000 and its accreditation has not been denied by the commissioner within ninety (90) days after submission of its application.
 - ~~(i) Maintains a surplus as regards policyholders in an amount not less than \$20,000,000 and whose accreditation has not been denied by the commissioner within ninety (90) days of its submission; or~~
 - ~~(ii) Maintains a surplus as regards policyholders in an amount less than \$20,000,000 and whose accreditation has been approved by the commissioner.~~
- ~~(2) Credit shall not be allowed a domestic ceding insurer if the assuming insurer's accreditation has been revoked by the commissioner after notice and hearing.~~

Drafting Note: To qualify as an accredited reinsurer, an assuming insurer must meet all of the requirements and the standards set forth in Subsection B. If the commissioner of insurance determines that the assuming insurer has failed to continue to meet any of these qualifications, the commissioner may, upon written notice and hearing, revoke accreditation.

- C. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is domiciled in, or in the case of a U.S. branch of an alien assuming insurer is entered through, a state that employs standards regarding credit for reinsurance substantially similar to those applicable under this statute and the assuming insurer or U.S. branch of an alien assuming insurer:
 - (a) Maintains a surplus as regards policyholders in an amount not less than \$20,000,000; and
 - (b) Submits to the authority of this state to examine its books and records.
- (2) The requirement of Section 2 C(1)(a) does not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system.

Drafting Note: The term “substantially similar” means standards that equal or exceed the standards of the enacting state, as determined by the commissioner of the enacting state. It is expected that the NAIC will maintain a list of states whose laws establish standards that equal or exceed the standards of this model act.

- D. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution, as defined in Section 4B, for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. To enable the

commissioner to determine the sufficiency of the trust fund, the assuming insurer shall report annually to the commissioner information substantially the same as that required to be reported on the NAIC Annual Statement form by licensed insurers. The assuming insurer shall submit to examination of its books and records by the commissioner and bear the expense of examination.

- (2) (a) Credit for reinsurance shall not be granted under this subsection unless the form of the trust and any amendments to the trust have been approved by:
- (i) The commissioner of the state where the trust is domiciled; or
 - (ii) The commissioner of another state who, pursuant to the terms of the trust instrument, has accepted principal regulatory oversight of the trust.
- (b) The form of the trust and any trust amendments also shall be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the United States. The trust shall vest legal title to its assets in its trustees for the benefit of the assuming insurer's U.S. ceding insurers, their assigns and successors in interest. The trust and the assuming insurer shall be subject to examination as determined by the commissioner.
- (c) The trust shall remain in effect for as long as the assuming insurer has outstanding obligations due under the reinsurance agreements subject to the trust. No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing the balance of the trust and listing the trust's investments at the preceding year-end and shall certify the date of termination of the trust, if so planned, or certify that the trust will not expire prior to the following December 31.
- (3) The following requirements apply to the following categories of assuming insurer:
- (a) The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers, and, in addition, the assuming insurer shall maintain a trusteed surplus of not less than \$20,000,000, except as provided in paragraph 3(b) of this subsection.
 - (b) At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trusteed surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of

business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trusteed surplus may not be reduced to an amount less than thirty percent (30%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust.

- (bc) (i) In the case of a group including incorporated and individual unincorporated underwriters:
- (I) For reinsurance ceded under reinsurance agreements with an inception, amendment or renewal date on or after ~~August 1, 1995~~January 1, 1993, the trust shall consist of a trusteed account in an amount not less than the ~~group's respective underwriters'~~ several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any ~~member~~underwriter of the group;
 - (II) For reinsurance ceded under reinsurance agreements with an inception date on or before ~~July 31, 1995~~December 31, 1992, and not amended or renewed after that date, notwithstanding the other provisions of this Act, the trust shall consist of a trusteed account in an amount not less than the ~~group's respective underwriters'~~ several insurance and reinsurance liabilities attributable to business written in the United States; and
 - (III) In addition to these trusts, the group shall maintain in trust a trusteed surplus of which \$100,000,000 shall be held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account; and
- (ii) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of regulation and solvency control by the group's domiciliary regulator as are the unincorporated members.
- (iii) Within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, the group shall provide to the commissioner an annual certification by the group's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the group.
- (ed) In the case of a group of incorporated underwriters under common administration, the group shall:
- (i) Have continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to making application for accreditation;

- (ii) Maintain aggregate policyholders' surplus of at least \$10,000,000,000;
- (iii) Maintain a trust fund in an amount not less than the group's several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group pursuant to reinsurance contracts issued in the name of the group;
- (iv) In addition, maintain a joint trusted surplus of which \$100,000,000 shall be held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group as additional security for these liabilities; and
- (v) Within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, make available to the commissioner an annual certification of each underwriter member's solvency by the member's domiciliary regulator and financial statements of each underwriter member of the group prepared by its independent public accountant.

Drafting Note: Unless otherwise stated, "commissioner" refers to the commissioner of insurance in the state where credit or a reduction from liability is taken.

Drafting Note: Consideration was given to deferring to state capital and surplus requirements as a threshold for the trusted surplus, but it was concluded that, on the basis of risk exposure and current industry security practices, the standards for credit should be higher under Subsection D. The \$100,000,000 trusted surplus requirement for a group including incorporated and individual unincorporated underwriters reflects the higher financial standards currently found among the states for a group of this type. The \$20,000,000 trusted surplus requirement is an option available to assuming insurers that do not satisfy both the licensing and financial standards of Subsection B or C.

E. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the commissioner as a reinsurer in this state and secures its obligations in accordance with the requirements of this subsection.

(1) In order to be eligible for certification, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner pursuant to paragraph (3) of this subsection:

(b) The assuming insurer must maintain minimum capital and surplus, or its equivalent, in an amount to be determined by the commissioner pursuant to regulation:

(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner pursuant to regulation:

(d) The assuming insurer must agree to submit to the jurisdiction of this state, appoint the commissioner as its agent for service of process in this state, and agree to provide security for 100 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment:

(e) The assuming insurer must agree to meet applicable information filing requirements as determined by the commissioner, both with

respect to an initial application for certification and on an ongoing basis; and

(f) The assuming insurer must satisfy any other requirements for certification deemed relevant by the commissioner.

(2) An association including incorporated and individual unincorporated underwriters may be a certified reinsurer. In order to be eligible for certification, in addition to satisfying requirements of paragraph (1):

(a) The association shall satisfy its minimum capital and surplus requirements through the capital and surplus equivalents (net of liabilities) of the association and its members, which shall include a joint central fund that may be applied to any unsatisfied obligation of the association or any of its members, in an amount determined by the commissioner to provide adequate protection;

(b) The incorporated members of the association shall not be engaged in any business other than underwriting as a member of the association and shall be subject to the same level of regulation and solvency control by the association's domiciliary regulator as are the unincorporated members; and

(c) Within ninety (90) days after its financial statements are due to be filed with the association's domiciliary regulator, the association shall provide to the commissioner an annual certification by the association's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.

(3) The commissioner shall create and publish a list of qualified jurisdictions, under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be considered for certification by the commissioner as a certified reinsurer.

(a) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. A jurisdiction may not be recognized as a qualified jurisdiction if the commissioner has determined that the jurisdiction does not adequately and promptly enforce final U.S. judgments and arbitration awards. Additional factors may be considered in the discretion of the commissioner.

(b) If the NAIC publishes a list of qualified jurisdictions, the commissioner may defer to this list.

- (c) U.S. jurisdictions that meet the requirement for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.
- (d) If a certified reinsurer's domiciliary jurisdiction ceases to be a qualified jurisdiction, the commissioner has the discretion to suspend the reinsurer's certification indefinitely, in lieu of revocation.
- (4) The commissioner shall assign a rating to each certified reinsurer, giving due consideration to the financial strength ratings that have been assigned by rating agencies deemed acceptable to the commissioner pursuant to regulation. The commissioner shall publish a list of all certified reinsurers and their ratings.
- (5) A certified reinsurer shall secure obligations assumed from U.S. ceding insurers under this subsection at a level consistent with its rating, as specified in regulations promulgated by the commissioner.
- (a) In order for a domestic ceding insurer to qualify for full financial statement credit for reinsurance ceded to a certified reinsurer, the certified reinsurer shall maintain security in a form acceptable to the commissioner and consistent with the provisions of Section 3, or in a multibeneficiary trust in accordance with Subsection D of this section, except as otherwise provided in this subsection.
- (b) If a certified reinsurer maintains a trust to fully secure its obligations subject to Subsection D of this section, and chooses to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer shall maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security as permitted by this subsection or comparable laws of other U.S. jurisdictions and for its obligations subject to Subsection D of this section. It shall be a condition to the grant of certification under Subsection E of this section that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.
- (c) The minimum trustee surplus requirements provided in Subsection D are not applicable with respect to a multibeneficiary trust maintained by a certified reinsurer for the purpose of securing obligations incurred under this subsection, except that such trust shall maintain a minimum trustee surplus of \$10,000,000.
- (d) With respect to obligations incurred by a certified reinsurer under this subsection, if the security is insufficient, the commissioner shall reduce the allowable credit by an amount proportionate to the deficiency, and has the discretion to impose further reductions in allowable credit upon finding that there is a material risk that the certified reinsurer's obligations will not be paid in full when due.
- (e) For purposes of this subsection, a certified reinsurer whose certification has been terminated for any reason shall be treated as a certified reinsurer required to secure 100% of its obligations.

~~(i) As used in this subsection, the term “terminated” refers to revocation, suspension, voluntary surrender and inactive status.~~

~~(ii) If the commissioner continues to assign a higher rating as permitted by other provisions of this section, this requirement does not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended.~~

~~(6) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction’s certification, and has the discretion to defer to the rating assigned by that jurisdiction, and such assuming insurer shall be considered to be a certified reinsurer in this state.~~

~~(7) A certified reinsurer that ceases to assume new business in this state may request to maintain its certification in inactive status in order to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer shall continue to comply with all applicable requirements of this subsection, and the commissioner shall assign a rating that takes into account, if relevant, the reasons why the reinsurer is not assuming new business.~~

~~EF.~~ Credit shall be allowed when the reinsurance is ceded to an assuming insurer not meeting the requirements of Subsections A, B, C, ~~or D~~ or E of this section, but only as to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

Drafting Note: For purposes of this subsection, “jurisdiction” refers to those jurisdictions other than the United States and also to any state, district or territory of the United States. Subsection E allows credit to ceding insurers that are mandated by these jurisdictions to cede to state-owned or controlled insurance or reinsurance companies or to participate in pools, guaranty associations or residual market mechanisms.

~~FG.~~ If the assuming insurer is not licensed, ~~or~~ accredited or certified to transact insurance or reinsurance in this state, the credit permitted by Subsections C and D of this section shall not be allowed unless the assuming insurer agrees in the reinsurance agreements:

(1) (a) That in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance agreement, the assuming insurer, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, will comply with all requirements necessary to give the court jurisdiction, and will abide by the final decision of the court or of any appellate court in the event of an appeal; and

(b) To designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the ceding ~~company~~ insurer.

(2) This subsection is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if this obligation is created in the agreement.

GH. If the assuming insurer does not meet the requirements of Subsections A, B or C, the credit permitted by Subsection D or E of this section shall not be allowed unless the assuming insurer agrees in the trust agreements to the following conditions:

- (1) Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by Subsection D(3) of this section, or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund.
- (2) The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic insurance companies.
- (3) If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. ceding insurers of the grantor of the trust, the assets or part thereof shall be returned by the commissioner with regulatory oversight to the trustee for distribution in accordance with the trust agreement.
- (4) The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

I. If an accredited or certified reinsurer ceases to meet the requirements for accreditation or certification, the commissioner may suspend or revoke the reinsurer's accreditation or certification.

- (1) The commissioner must give the reinsurer notice and opportunity for hearing. The suspension or revocation may not take effect until after the commissioner's order on hearing, unless:
 - (a) The reinsurer waives its right to hearing;
 - (b) The commissioner's order is based on regulatory action by the reinsurer's domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer's eligibility to transact insurance or reinsurance business in its domiciliary jurisdiction or in the primary certifying state of the reinsurer under Subparagraph E(6) of this section; or
 - (c) The commissioner finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the commissioner's action.
- (2) While a reinsurer's accreditation or certification is suspended, no reinsurance contract issued or renewed after the effective date of the suspension qualifies for credit except to the extent that the reinsurer's obligations under the contract are secured in accordance with section 3. If a reinsurer's accreditation or certification is revoked, no credit for reinsurance may be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured in accordance with Paragraph E(5) or Section 3.

Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C. (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding ~~company~~insurer on or before the filing date of its annual statement;
- (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

Drafting Note: Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

Drafting Note: There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

~~Optional Section Drafting Note: This model act applies only to the domestic ceding insurers of the enacting state. However, if the enacting state wishes to impose credit for reinsurance standards on foreign insurers, the following language should be inserted as Section 4 and the succeeding sections of the model act should be renumbered accordingly.~~

~~**Section []. Credit Allowed a Foreign Ceding Insurer [Optional]**~~

~~A. Credit for reinsurance or reduction from liability shall be allowed a foreign ceding insurer to the extent that credit has been allowed by the ceding insurer's state of domicile if:~~

~~(1) The state of domicile is accredited by the National Association of Insurance Commissioners; or~~

~~(2) Credit or reduction from liability would be allowed under this statute if the foreign ceding insurer were domiciled in this state.~~

~~B. Credit for reinsurance or reduction from liability may be disallowed a foreign ceding insurer upon a finding by the commissioner that neither the condition of the reinsurer nor the collateral or other security provided by the reinsurer satisfies the credit for reinsurance requirements of this Act applicable to ceding insurers domiciled in this state.~~

Section 4. Qualified U.S. Financial Institutions

- A. For purposes of Section 3C, a “qualified U.S. financial institution” means an institution that:
- (1) Is organized or (in the case of a U.S. office of a foreign banking organization) licensed, under the laws of the United States or any state thereof;
 - (2) Is regulated, supervised and examined by U.S. federal or state authorities having regulatory authority over banks and trust companies; and
 - (3) Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.

Drafting Note: The NAIC’s Securities Valuation Office (SVO) maintains, on a current basis, a list of all U.S. financial institutions that have, upon application to the SVO, been determined to meet the eligibility standards of its *Purposes and Procedures Manual*. These standards, developed by the NAIC’s Letter of Credit (EX4) Study Group, make use of nationally recognized ratings services, and are more rigorous in the case of foreign banking organizations (whose standby letters of credit must be issued or confirmed by a qualified U.S. financial institution) than those that are applicable to domestic financial institutions whose standby letters of credit would be considered acceptable.

- B. A “qualified U.S. financial institution” means, for purposes of those provisions of this law specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:
- (1) Is organized, or, in the case of a U.S. branch or agency office of a foreign banking organization, licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and
 - (2) Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.

Drafting Note: Because assets held in a fiduciary capacity are not subject to the claims of the trustee’s creditors, and because the trust departments of all U.S. financial institutions (including U.S. branch or agency offices of foreign banking organizations having fiduciary powers in the U.S.) are regulated, supervised and examined by the institution’s primary U.S. bank regulatory authority (federal or state), there is no need to apply additional standards measuring the financial condition or standing of the institution, as in the case of determining those institutions whose standby letter of credit obligations will be considered acceptable.

Section 5. Rules and Regulations

The commissioner may adopt rules and regulations implementing the provisions of this law.

Drafting Note: It is recognized that credit for reinsurance also can be affected by other sections of the enacting state’s code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.

Section 6. Reinsurance Agreements Affected

This Act shall apply to all cessions after the effective date of this Act under reinsurance agreements that have an inception, anniversary or renewal date not less than six (6) months after the effective date of this Act.

Drafting Note: The enacting state may wish to provide a delay in the applicability greater than six (6) months to allow time for the insurance commissioner to promulgate regulations and to allow reinsurers to prepare and submit qualifying data.

Legislative History (All references are to the Proceedings of the NAIC).

1984 Proc. II 9, 29, 822, 836, 837-839 (adopted).

1986 Proc. I 9-10, 24, 799, 811, 812 (corrected).

1987 Proc. II 15, 24, 444-448, 832, 854, 856 (amended and reprinted).

1990 Proc. I 12-14, 851, 857-861 (amended at special plenary session September 1989 and reprinted).

1990 Proc. I 6, 30, 840, 872, 875-878 (technical amendments adopted at winter plenary and reprinted).

1990 Proc. II 7, 18, 748, 766, 780-783 (amended).

1993 Proc. 4th Quarter 6, 31, 835-836, 874, 891 (amended).

1996 Proc. 2nd Quarter 12, 12-17, 24, 862 (amended and reprinted).

**REQUEST FOR MODEL LAW DEVELOPMENT
CREDIT FOR REINSURANCE MODEL REGULATION (#786)**

This form is intended to gather information to support the development of a new model law or amendment to an existing model law. Prior to development of a new or amended model law, approval of the respective Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for model law development. Please complete all questions and provide as much detail as necessary to help in this determination.

Please check whether this is: New Model Law or Amendment to Existing Model

1. Name of group to be responsible for drafting the model:

Reinsurance (E) Task Force

2. NAIC staff support contact information:

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3. Please provide a description and proposed title of the new model law. If an existing law, please provide the title, attach a current version to this form and reference the section(s) proposed to be amended.

Credit for Reinsurance Model Regulation (Model #786) (copy attached)

Sections Proposed to be Amended: Section 7(B) would be amended to allow the commissioner with principal regulatory oversight of the trust the discretion to reduce the minimum trustee surplus requirement for a multiple-beneficiary trust fund maintained by an assuming insurer in run-off.

UPDATE: The Reinsurance Task Force will also begin discussions on amending Model #785 to incorporate key elements of the Reinsurance Regulatory Modernization Framework Proposal, which was previously adopted by the NAIC at the Winter 2008 National Meeting. The Task Force previously approved a resolution for NAIC staff to initiate the model law process with respect to these changes at the Summer 2009 National Meeting, and it is expected that the Task Force will confirm this request at this meeting.

4. **Does the model law meet the Model Law Criteria?** **Yes** or **No** (Check one)
(If answering no to any of these questions, please reevaluate charge and proceed accordingly to address issues).

a. **Does the subject of the model law necessitate a national standard and require uniformity amongst all states?** **Yes** or **No** (Check one)

If yes, please explain why

Model #786 provides that credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the assuming insurer meets one of the following criteria:

1. The assuming insurer is licensed in the same state of domicile as the ceding company for a like kind of business.
2. The assuming insurer is accredited by the domiciliary insurance department of the ceding company.
3. The assuming insurer is domiciled and licensed in a state with substantially similar credit for reinsurance laws as the domiciliary state of the ceding company.
4. The assuming insurer provides collateral in the form of a multiple-beneficiary trust.
5. The assuming insurer provides collateral or other security to the ceding insurer.

With respect to number (4) above, Section Section 7 of Model #786 provides the requirements for an assuming insurer that maintains a multiple-beneficiary trust for the purposes of securing reinsurance obligations to U.S. ceding companies. With respect to the required balance for such a multiple-beneficiary trust, Model #786 provides the following: "The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. domiciled insurers, and, in addition, the assuming insurer shall maintain a trustee surplus of not less than \$20,000,000."

After considering a proposal submitted by an interested party the Reinsurance Task Force reached a consensus that the \$20 million minimum trustee surplus requirement for a multiple-beneficiary trust can become problematic with respect to solvency and liquidity for an assuming insurer that has entered into run-off. As the liabilities attributable to the U.S. trust are reduced, the percentage of total collateral in the trust becomes disproportionately high in relation to the assuming insurer's obligations to U.S. cedants. The Reinsurance Task Force has determined that under the appropriate circumstances, it is prudent for the minimum trustee surplus requirement to be reduced as the assuming insurer's obligations to U.S. cedants decrease. State regulations based on (or substantially similar to) Model #786 would require amendment in order to prevent such reduction in a multiple-beneficiary trust balance from negatively impacting the policyholders' surplus of U.S. ceding companies that are taking financial statement credit for reinsurance ceded to the applicable assuming insurer.

The Task Force is proposing to amend Model #786 to allow the commissioner with principal regulatory oversight of the trust the discretion to reduce the minimum trustee surplus requirement for a multiple-beneficiary trust fund maintained by an assuming insurer in run-off. The Task Force reached a consensus that the reduction in trustee surplus would be subject to the following parameters: At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trustee surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trustee surplus may not be reduced to an amount less than (30% or 50% minimum is yet to be decided) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers.

While the proposed amendment would potentially reduce the minimum trustee surplus requirement applicable to a multiple-beneficiary trust, it should be noted that it would not alter the requirement that the trust balance cover 100% of the assuming insurer's obligations to U.S. cedants.

Model #786 is referenced in the current Accreditation Standards. It is understood that specific state law which is determined to be more conservative than the related accreditation standard is generally considered to be acceptable in meeting such standard. As the proposed amendment would result in a less conservative minimum trustee surplus requirement for a multiple-beneficiary trust than the requirement under the current standard, no U.S. jurisdiction that is accredited under the current standard would be required to adopt this proposed amendment in order to maintain its accreditation status. However, in order for the proposed amendment to be effective in practice, uniform adoption throughout all U.S. jurisdictions would be necessary. An assuming insurer providing creditable reinsurance within the U.S. pursuant to this section of Model #786 maintains a single trust account in the U.S. for the benefit of its U.S. cedants. Therefore, the single trust account would have to meet the requirements of the most conservative state laws with respect to minimum trustee surplus/minimum trust balance in order for U.S. cedants domiciled in such jurisdictions to be eligible to receive full financial statement credit for reinsurance ceded to the applicable assuming insurer.

b. Does Committee believe NAIC members should devote significant regulator and Association resources to educate, communicate and support this model law?

Yes or No (Check one)

5. What is the likelihood that your Committee will be able to draft and adopt the model law within one year from the date of Executive Committee approval?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: The Task Force contemplated possible language to address this issue during its consideration of the proposal. Based on the high degree of consensus expressed during those discussions, it is very likely that the Task Force will finalize the amendment language in a very short time frame.

6. What is the likelihood that a minimum two-thirds majority of NAIC members would ultimately vote to adopt the proposed model law?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Given the high degree of consensus among the 30 members of the Reinsurance Task Force during consideration of this proposal (no members expressed opposition in proceeding with the request for Model Law development), it is likely that a two-thirds majority of NAIC members would be in support of the proposed amendment.

7. What is the likelihood that state legislature will adopt the model law in a uniform manner within three years of adoption by the NAIC?

1 2 3 4 5 (Check one)

High Likelihood

Low Likelihood

Explanation, if necessary: Ultimate adoption by state legislatures is less certain. States would not be required to adopt the proposed amendment in order to maintain NAIC accreditation, as the current accreditation standard would be considered more conservative. The degree of likelihood will probably increase in the event that state legislatures consider more extensive reinsurance collateral reforms in the near future.

8. Is this model law referenced in the Accreditation Standards? If so, does the standard require the model law to be adopted in a substantially similar manner?

Model #786 is referenced in the Accreditation Standards for Reinsurance Ceded. Section 10 reads as follows:

10. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation and the NAIC Life and Health Reinsurance Agreement Model Regulation or substantially similar laws.

9. Is this model law in response to or impacted by federal laws or regulations? If yes, please explain.

Not Applicable

Preface to Credit for Reinsurance Models

The amendments to the NAIC Credit for Reinsurance Model Law (#785) & Regulation (#786) are part of a larger effort to modernize reinsurance regulation in the United States. The NAIC initially adopted the Reinsurance Regulatory Modernization Framework Proposal during its 2008 Winter National Meeting. The NAIC recommended that this framework be implemented through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation. In addition to this proposed federal legislation, the framework also provided that changes to state insurance laws should be considered. For example, state laws to establish requirements under which states would regulate qualified reinsurers, and also to consider reinsurance risk diversification and notice requirements for ceding insurers.

On July 21, 2010, Congress passed and the President signed related federal legislation, the Nonadmitted and Reinsurance Reform Act, which became effective July 21, 2011. While this act does not implement the NAIC framework, it does preempt the extraterritorial application of state credit for reinsurance law and permits states of domicile to proceed forward with reinsurance collateral reforms on an individual basis if they are accredited. This federal legislation also does not prohibit the states from acting together, through the NAIC, to achieve the reinsurance modernization framework goals. In addition to the current work on the credit for reinsurance models, the NAIC will continue its efforts to implement other aspects of the framework. These efforts will continue both through work conducted by the Reinsurance Task Force and through referrals to the appropriate groups within the NAIC. In addition, the NAIC will consider a proposal to form a new group to provide high quality review of reinsurance collateral reduction applications and assistance to the states. Such a process with respect to the review of applications for reinsurance collateral reduction and qualified jurisdictions should strengthen state regulation and prevent regulatory arbitrage. Such an effort would be supported by NAIC staff with substantial expertise to carry out the functions of such a group.

Finally, the NAIC will continue to work on requirements for NAIC review and approval of qualified jurisdictions, and will undertake a re-examination of the collateral amounts within two years from the effective date of the revisions to the models.

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Section 1. Authority

This regulation is promulgated pursuant to the authority granted by Sections [insert applicable section number] and [insert applicable section number] of the Insurance Code.

Section 2. Purpose

The purpose of this regulation is to set forth rules and procedural requirements that the commissioner deems necessary to carry out the provisions of the [cite state law equivalent to the Credit for Reinsurance Model Law] (the Act). The actions and information required by this regulation are declared to be necessary and appropriate in the public interest and for the protection of the ceding insurers in this state.

Section 3. Severability

If any provision of this regulation, or the application of the provision to any person or circumstance, is held invalid, the remainder of the regulation, and the application of the provision to persons or circumstances other than those to which it is held invalid, shall not be affected.

Section 4. Credit for Reinsurance—Reinsurer Licensed in this State

Pursuant to Section [cite state law equivalent of Section 2A of the Credit for Reinsurance Model Law] the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that was licensed in this state as of any date on which statutory financial statement credit for reinsurance is claimed.

Drafting Note: “Statutory financial statement” means quarterly, annual or other financial statements required by state law. The drafters conditioned the recognition of credit on matters reported, existing or occurring “as of any date on which” statutory financial statement credit is claimed or a financial statement is filed to ensure that requisite conditions for credit exist at the time the credit is claimed or reported and that the conditions remained satisfied at all times thereafter until information reported in one statement was replaced by information reported in a subsequently filed statement. Insurers are to satisfy requisite conditions at the time credit is first taken and shall maintain compliance at all times thereafter in which the credit is taken. The drafters believe the requirements to be perpetual, not periodic.

Credit for Reinsurance Regulation

Section 5. Credit for Reinsurance—Accredited Reinsurers

- A. Pursuant to Section [cite state law equivalent of Section 2B of the Credit for Reinsurance Model Law] the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that is accredited as a reinsurer in this state as of ~~any~~the date on which statutory financial statement credit for reinsurance is claimed. An accredited reinsurer must:
- (1) Files a properly executed Form AR-1 (attached as an exhibit to this regulation) as evidence of its submission to this state's jurisdiction and to this state's authority to examine its books and records;
 - (2) Files with the commissioner a certified copy of a certificate of authority or other acceptable evidence that it is licensed to transact insurance or reinsurance in at least one state, or, in the case of a U.S. branch of an alien assuming insurer, is entered through and licensed to transact insurance or reinsurance in at least one state;
 - (3) Files annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile or, in the case of an alien assuming insurer, with the state through which it is entered and in which it is licensed to transact insurance or reinsurance, and a copy of its most recent audited financial statement; and
 - ~~(4) Maintains a surplus as regards policyholders in an amount not less than \$20,000,000, or obtain the affirmative approval of the commissioner upon a finding that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers, and whose accreditation has not been denied by the commissioner within ninety (90) days of its submission; or~~
 - ~~(b) Maintains a surplus as regards policyholders of less than \$20,000,000, and whose accreditation has been approved by the commissioner.~~
- B. If the commissioner determines that the assuming insurer has failed to meet or maintain any of these qualifications, the commissioner may upon written notice and opportunity for hearing, suspend or revoke the accreditation. Credit shall not be allowed a domestic ceding insurer under this section if the assuming insurer's accreditation has been revoked by the commissioner, or if the reinsurance was ceded while the assuming insurer's accreditation was under suspension by the commissioner.

Section 6. Credit for Reinsurance—Reinsurer Domiciled in Another State

- A. Pursuant to Section [cite state law equivalent to Section 2C of the Credit for Reinsurance Model Law] the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that as of any date on which statutory financial statement credit for reinsurance is claimed:
- (1) Is domiciled in (or, in the case of a U.S. branch of an alien assuming insurer, is entered through) a state that employs standards regarding credit for reinsurance substantially similar to those applicable under the Act and this regulation;

Drafting Note: This subsection is intended to apply to an assuming insurer domiciled in (or, in the case of the U.S. branch of an alien assuming insurer, entered through) another state only if the assuming insurer also is licensed in that state and is therefore subject to the application of the state's credit for reinsurance standards as the result of the imposition of licensure requirements and also regulatory oversight and examination as a domiciliary company.

- (2) Maintains a surplus as regards policyholders in an amount not less than \$20,000,000; and
 - (3) Files a properly executed Form AR-1 with the commissioner as evidence of its submission to this state's authority to examine its books and records.
- B. The provisions of this section relating to surplus as regards policyholders shall not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system. As used in this section, "substantially similar" standards means credit for reinsurance standards that the commissioner determines equal or exceed the standards of the Act and this regulation.

Section 7. Credit for Reinsurance—Reinsurers Maintaining Trust Funds

- A. Pursuant to Section [cite state law equivalent to Section 2D of the Credit for Reinsurance Model Law] the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer which, as of any date on which statutory financial statement credit for reinsurance is claimed, and thereafter for so long as credit for reinsurance is claimed, maintains a trust fund in an amount prescribed below in a qualified U.S. financial institution as defined in Section [cite state law equivalent to Section 4B of the Credit for Reinsurance Model Law] of the Act, for the payment of the valid claims of its U.S. domiciled ceding insurers, their assigns and successors in interest. The assuming insurer shall report annually to the commissioner substantially the same information as that required to be reported on the National Association of Insurance Commissioners (NAIC) annual statement form by licensed insurers, to enable the commissioner to determine the sufficiency of the trust fund.
- B. The following requirements apply to the following categories of assuming insurer:
- (1) The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. domiciled insurers, and in addition, the assuming insurer shall maintain a trustee surplus of not less than \$20,000,000, except as provided in paragraph (2) of this subsection.
 - (2) At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trustee surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trustee surplus may not be reduced to an amount less than thirty percent (30%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust.

- (23) (a) The trust fund for a group including incorporated and individual unincorporated underwriters shall consist of:
- (i) For reinsurance ceded under reinsurance agreements with an inception, amendment or renewal date on or after ~~August 1, 1995~~ January 1, 1993, funds in trust in an amount not less than the ~~group's~~ group's ~~respective underwriters'~~ respective underwriters' several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any ~~member~~ underwriter of the group;
 - (ii) For reinsurance ceded under reinsurance agreements with an inception date on or before ~~July 31, 1995~~ December 31, 1992, and not amended or renewed after that date, notwithstanding the other provisions of this regulation, funds in trust in an amount not less than the ~~group's~~ group's ~~respective underwriters'~~ respective underwriters' several insurance and reinsurance liabilities attributable to business written in the United States; and
 - (iii) In addition to these trusts, the group shall maintain a trusted surplus of which \$100,000,000 shall be held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all the years of account.
- (b) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of regulation and solvency control by the group's domiciliary regulator as are the unincorporated members. The group shall, within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, provide to the commissioner:
- (i) An annual certification by the group's domiciliary regulator of the solvency of each underwriter member of the group; or
 - (ii) If a certification is unavailable, a financial statement, prepared by independent public accountants, of each underwriter member of the group.
- (34) (a) The trust fund for a group of incorporated insurers under common administration, whose members possess aggregate policyholders surplus of \$10,000,000,000 (calculated and reported in substantially the same manner as prescribed by the annual statement instructions and *Accounting Practices and Procedures Manual* of the NAIC) and which has continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to making application for accreditation, shall:
- (i) Consist of funds in trust in an amount not less than the assuming insurers' several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any members of the group pursuant to reinsurance contracts issued in the name of such group;
 - (ii) Maintain a joint trusted surplus of which \$100,000,000 shall be held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group; and

- (iii) File a properly executed Form AR-1 as evidence of the submission to this state's authority to examine the books and records of any of its members and shall certify that any member examined will bear the expense of any such examination.
 - (b) Within ninety (90) days after the statements are due to be filed with the group's domiciliary regulator, the group shall file with the commissioner an annual certification of each underwriter member's solvency by the member's domiciliary regulators, and financial statements, prepared by independent public accountants, of each underwriter member of the group.
- C.
 - (1) Credit for reinsurance shall not be granted unless the form of the trust and any amendments to the trust have been approved by either the commissioner of the state where the trust is domiciled or the commissioner of another state who, pursuant to the terms of the trust instrument, has accepted responsibility for regulatory oversight of the trust. The form of the trust and any trust amendments also shall be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled. The trust instrument shall provide that:
 - (a) Contested claims shall be valid and enforceable out of funds in trust to the extent remaining unsatisfied thirty (30) days after entry of the final order of any court of competent jurisdiction in the United States;
 - (b) Legal title to the assets of the trust shall be vested in the trustee for the benefit of the grantor's U.S. ceding insurers, their assigns and successors in interest;
 - (c) The trust shall be subject to examination as determined by the commissioner;
 - (d) The trust shall remain in effect for as long as the assuming insurer, or any member or former member of a group of insurers, shall have outstanding obligations under reinsurance agreements subject to the trust; and
 - (e) No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing setting forth the balance in the trust and listing the trust's investments at the preceding year-end, and shall certify the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the following December 31.
 - (2)
 - (a) Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by this subsection or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight over the trust or other designated receiver all of the assets of the trust fund.

- (b) The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight over the trust in accordance with the laws of the state in which the trust is domiciled applicable to the liquidation of domestic insurance companies.
- (c) If the commissioner with regulatory oversight over the trust determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. beneficiaries of the trust, the commissioner with regulatory oversight over the trust shall return the assets, or any part thereof, to the trustee for distribution in accordance with the trust agreement.
- (d) The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

D. For purposes of this ~~regulation~~section, the term “liabilities” shall mean the assuming insurer’s gross liabilities attributable to reinsurance ceded by U.S. domiciled insurers excluding liabilities that are ~~not~~ otherwise secured by acceptable means, and, shall include:

- (1) For business ceded by domestic insurers authorized to write accident and health, and property and casualty insurance:
 - (a) Losses and allocated loss expenses paid by the ceding insurer, recoverable from the assuming insurer;
 - (b) Reserves for losses reported and outstanding;
 - (c) Reserves for losses incurred but not reported;
 - (d) Reserves for allocated loss expenses; and
 - (e) Unearned premiums.
- (2) For business ceded by domestic insurers authorized to write life, health and annuity insurance:
 - (a) Aggregate reserves for life policies and contracts net of policy loans and net due and deferred premiums;
 - (b) Aggregate reserves for accident and health policies;
 - (c) Deposit funds and other liabilities without life or disability contingencies; and
 - (d) Liabilities for policy and contract claims.

E. Assets deposited in trusts established pursuant to [cite state law equivalent to Section 2 of the Credit for Reinsurance Model Law] and this section shall be valued according to their current fair market value and shall consist only of cash in U.S. dollars, certificates of deposit issued by a U.S. financial institution as defined in [cite state law equivalent of Section 4A of the Credit for Reinsurance Model Law], clean, irrevocable, unconditional and “evergreen” letters of credit issued or confirmed by a qualified U.S. financial institution, as defined in [cite state law equivalent of Section 4A of the Credit for Reinsurance Model Law], and investments of the type specified in this subsection, but investments in or issued by an entity controlling, controlled by

or under common control with either the grantor or beneficiary of the trust shall not exceed five percent (5%) of total investments. No more than twenty percent (20%) of the total of the investments in the trust may be foreign investments authorized under Paragraphs (1)(e), (3), (6)(b) or (7) of this subsection, and no more than ten percent (10%) of the total of the investments in the trust may be securities denominated in foreign currencies. For purposes of applying the preceding sentence, a depository receipt denominated in U.S. dollars and representing rights conferred by a foreign security shall be classified as a foreign investment denominated in a foreign currency. The assets of a trust established to satisfy the requirements of Section [cite state law equivalent to Section 2 of the Credit for Reinsurance Model Law] shall be invested only as follows:

- (1) Government obligations that are not in default as to principal or interest, that are valid and legally authorized and that are issued, assumed or guaranteed by:
 - (a) The United States or by any agency or instrumentality of the United States;
 - (b) A state of the United States;
 - (c) A territory, possession or other governmental unit of the United States;
 - (d) An agency or instrumentality of a governmental unit referred to in Subparagraphs (b) and (c) of this paragraph if the obligations shall be by law (statutory or otherwise) payable, as to both principal and interest, from taxes levied or by law required to be levied or from adequate special revenues pledged or otherwise appropriated or by law required to be provided for making these payments, but shall not be obligations eligible for investment under this paragraph if payable solely out of special assessments on properties benefited by local improvements; or
 - (e) The government of any other country that is a member of the Organization for Economic Cooperation and Development and whose government obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;
- (2) Obligations that are issued in the United States, or that are dollar denominated and issued in a non-U.S. market, by a solvent U.S. institution (other than an insurance company) or that are assumed or guaranteed by a solvent U.S. institution (other than an insurance company) and that are not in default as to principal or interest if the obligations:
 - (a) Are rated A or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC, or if not so rated, are similar in structure and other material respects to other obligations of the same institution that are so rated;
 - (b) Are insured by at least one authorized insurer (other than the investing insurer or a parent, subsidiary or affiliate of the investing insurer) licensed to insure obligations in this state and, after considering the insurance, are rated AAA (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC; or

- (c) Have been designated as Class One or Class Two by the Securities Valuation Office of the NAIC;
- (3) Obligations issued, assumed or guaranteed by a solvent non-U.S. institution chartered in a country that is a member of the Organization for Economic Cooperation and Development or obligations of U.S. corporations issued in a non-U.S. currency, provided that in either case the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;
- (4) An investment made pursuant to the provisions of Paragraph (1), (2) or (3) of this subsection shall be subject to the following additional limitations:
 - (a) An investment in or loan upon the obligations of an institution other than an institution that issues mortgage-related securities shall not exceed five percent (5%) of the assets of the trust;
 - (b) An investment in any one mortgage-related security shall not exceed five percent (5%) of the assets of the trust;
 - (c) The aggregate total investment in mortgage-related securities shall not exceed twenty-five percent (25%) of the assets of the trust; and
 - (d) Preferred or guaranteed shares issued or guaranteed by a solvent U.S. institution are permissible investments if all of the institution's obligations are eligible as investments under Paragraphs (2)(a) and (2)(c) of this subsection, but shall not exceed two percent (2%) of the assets of the trust.
- (5) As used in this regulation:
 - (a) "Mortgage-related security" means an obligation that is rated AA or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC and that either:
 - (i) Represents ownership of one or more promissory notes or certificates of interest or participation in the notes (including any rights designed to assure servicing of, or the receipt or timeliness of receipt by the holders of the notes, certificates, or participation of amounts payable under, the notes, certificates or participation), that:
 - (I) Are directly secured by a first lien on a single parcel of real estate, including stock allocated to a dwelling unit in a residential cooperative housing corporation, upon which is located a dwelling or mixed residential and commercial structure, or on a residential manufactured home as defined in 42 U.S.C.A. Section 5402(6), whether the manufactured home is considered real or personal property under the laws of the state in which it is located; and
 - (II) Were originated by a savings and loan association, savings bank, commercial bank, credit union, insurance company, or similar institution that is supervised and examined by a federal or state housing

authority, or by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Sections 1709 and 1715-b, or, where the notes involve a lien on the manufactured home, by an institution or by a financial institution approved for insurance by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Section 1703; or

- (ii) Is secured by one or more promissory notes or certificates of deposit or participations in the notes (with or without recourse to the insurer of the notes) and, by its terms, provides for payments of principal in relation to payments, or reasonable projections of payments, or notes meeting the requirements of Items (i)(I) and (i)(II) of this subsection;
 - (b) “Promissory note,” when used in connection with a manufactured home, shall also include a loan, advance or credit sale as evidenced by a retail installment sales contract or other instrument.
- (6) Equity interests
- (a) Investments in common shares or partnership interests of a solvent U.S. institution are permissible if:
 - (i) Its obligations and preferred shares, if any, are eligible as investments under this subsection; and
 - (ii) The equity interests of the institution (except an insurance company) are registered on a national securities exchange as provided in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78kk or otherwise registered pursuant to that Act, and if otherwise registered, price quotations for them are furnished through a nationwide automated quotations system approved by the ~~National Association of Securities Dealers, Inc.~~Financial Industry Regulatory Authority, or successor organization. A trust shall not invest in equity interests under this paragraph an amount exceeding one percent (1%) of the assets of the trust even though the equity interests are not so registered and are not issued by an insurance company;
 - (b) Investments in common shares of a solvent institution organized under the laws of a country that is a member of the Organization for Economic Cooperation and Development, if:
 - (i) All its obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; and
 - (ii) The equity interests of the institution are registered on a securities exchange regulated by the government of a country that is a member of the Organization for Economic Cooperation and Development;
 - (c) An investment in or loan upon any one institution’s outstanding equity interests shall not exceed one percent (1%) of the assets of the trust. The cost of an investment in equity interests made pursuant to

this paragraph, when added to the aggregate cost of other investments in equity interests then held pursuant to this paragraph, shall not exceed ten percent (10%) of the assets in the trust;

- (7) Obligations issued, assumed or guaranteed by a multinational development bank, provided the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC.

Drafting Note: Banks such as the International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, Inter-American Development Bank, Asian Development Bank, African Development Bank, International Finance Corporation are intended to qualify under this section.

(8) Investment companies

- (a) Securities of an investment company registered pursuant to the Investment Company Act of 1940, 15 U.S.C. § 80a, are permissible investments if the investment company:

- (i) Invests at least ninety percent (90%) of its assets in the types of securities that qualify as an investment under Paragraph (1), (2) or (3) of this subsection or invests in securities that are determined by the commissioner to be substantively similar to the types of securities set forth in Paragraph (1), (2) or (3) of this subsection; or
- (ii) Invests at least ninety percent (90%) of its assets in the types of equity interests that qualify as an investment under Paragraph (6)(a) of this subsection;

- (b) Investments made by a trust in investment companies under this paragraph shall not exceed the following limitations:

- (i) An investment in an investment company qualifying under Subparagraph (a)(i) of this paragraph shall not exceed ten percent (10%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall not exceed twenty-five percent (25%) of the assets in the trust; and
- (ii) Investments in an investment company qualifying under Subparagraph (a)(ii) of this paragraph shall not exceed five percent (5%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall be included when calculating the permissible aggregate value of equity interests pursuant to Paragraph (6)(a) of this subsection.

(9) Letters of Credit

- (a) In order for a letter of credit to qualify as an asset of the trust, the trustee shall have the right and the obligation pursuant to the deed of trust or some other binding agreement (as duly approved by the commissioner), to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced.

- (b) The trust agreement shall provide that the trustee shall be liable for its negligence, willful misconduct or lack of good faith. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall be deemed to be negligence and/or willful misconduct.
- F. A specific security provided to a ceding insurer by an assuming insurer pursuant to Section 9 of this regulation shall be applied, until exhausted, to the payment of liabilities of the assuming insurer to the ceding insurer holding the specific security prior to, and as a condition precedent for, presentation of a claim by the ceding insurer for payment by a trustee of a trust established by the assuming insurer pursuant to this section.

Section 8. Credit for Reinsurance—Certified Reinsurers

A. Pursuant to [cite state law equivalent of Section 2E of the Credit for Reinsurance Model Law], the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that has been certified as a reinsurer in this state at all times for which statutory financial statement credit for reinsurance is claimed under this section. The credit allowed shall be based upon the security held by or on behalf of the ceding insurer in accordance with a rating assigned to the certified reinsurer by the commissioner. The security shall be in a form consistent with the provisions of [cite state law equivalent of Section 2E and Section 3 of the Credit for Reinsurance Model Law] and 11, 12 or 13 of this Regulation. The amount of security required in order for full credit to be allowed shall correspond with the following requirements:

(1) Ratings Security Required

<u>Secure – 1</u>	<u>0%</u>
<u>Secure – 2</u>	<u>10%</u>
<u>Secure – 3</u>	<u>20%</u>
<u>Secure – 4</u>	<u>50%</u>
<u>Secure – 5</u>	<u>75%</u>
<u>Vulnerable – 6</u>	<u>100%</u>

- (2) Affiliated reinsurance transactions shall receive the same opportunity for reduced security requirements as all other reinsurance transactions.
- (3) The commissioner shall require the certified reinsurer to post one hundred percent (100%), for the benefit of the ceding insurer or its estate, security upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurer.
- (4) In order to facilitate the prompt payment of claims, a certified reinsurer shall not be required to post security for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the certified reinsurer continuing to pay claims in a timely manner. Reinsurance recoverables for only the following lines of business as reported

on the NAIC annual financial statement related specifically to the catastrophic occurrence will be included in the deferral:

- (a) Line 1: Fire
- (b) Line 2: Allied Lines
- (c) Line 3: Farmowners multiple peril
- (d) Line 4: Homeowners multiple peril
- (e) Line 5: Commercial multiple peril
- (f) Line 9: Inland Marine
- (g) Line 12: Earthquake
- (h) Line 21: Auto physical damage

- (5) Credit for reinsurance under this section shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer. Any reinsurance contract entered into prior to the effective date of the certification of the assuming insurer that is subsequently amended after the effective date of the certification of the assuming insurer, or a new reinsurance contract, covering any risk for which collateral was provided previously, shall only be subject to this section with respect to losses incurred and reserves reported from and after the effective date of the amendment or new contract.
- (6) Nothing in this section shall prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for certified reinsurers under this Section.

B. Certification Procedure.

- (1) The commissioner shall post notice on the insurance department's website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The commissioner may not take final action on the application until at least thirty (30) days after posting the notice required by this paragraph.

Drafting Note: States that do not wish to make the internet the required mechanism for providing public notice should modify this provision accordingly. This provision was intended to provide a less formal notice requirement than is typically called for under state Administrative Procedure Acts.

- (2) The commissioner shall issue written notice to an assuming insurer that has made application and been approved as a certified reinsurer. Included in such notice shall be the rating assigned the certified reinsurer in accordance with Subsection A of this section. The commissioner shall publish a list of all certified reinsurers and their ratings.
- (3) In order to be eligible for certification, the assuming insurer shall meet the following requirements:
 - (a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a Qualified Jurisdiction, as determined by the commissioner pursuant to Subsection C of this section.
 - (b) The assuming insurer must maintain capital and surplus, or its equivalent, of no less than \$250,000,000 calculated in accordance with Subparagraph (4)(h) of this subsection. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and

surplus equivalents (net of liabilities) of at least \$250,000,000 and a central fund containing a balance of at least \$250,000,000.

(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. These ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. These financial strength ratings will be one factor used by the commissioner in determining the rating that is assigned to the assuming insurer. Acceptable rating agencies include the following:

- (i) Standard & Poor's;
- (ii) Moody's Investors Service;
- (iii) Fitch Ratings;
- (iv) A.M. Best Company; or
- (v) Any other Nationally Recognized Statistical Rating Organization.

(d) The certified reinsurer must comply with any other requirements reasonably imposed by the commissioner.

(4) Each certified reinsurer shall be rated on a legal entity basis, with due consideration being given to the group rating where appropriate, except that an association including incorporated and individual unincorporated underwriters that has been approved to do business as a single certified reinsurer may be evaluated on the basis of its group rating. Factors that may be considered as part of the evaluation process include, but are not limited, to the following:

(a) The certified reinsurer's financial strength rating from an acceptable rating agency. The maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as outlined in the table below. The commissioner shall use the lowest financial strength rating received from an approved rating agency in establishing the maximum rating of a certified reinsurer. A failure to obtain or maintain at least two financial strength ratings from acceptable rating agencies will result in loss of eligibility for certification:

<u>Ratings</u>	<u>Best</u>	<u>S&P</u>	<u>Moody's</u>	<u>Fitch</u>
<u>Secure – 1</u>	<u>A++</u>	<u>AAA</u>	<u>Aaa</u>	<u>AAA</u>
<u>Secure – 2</u>	<u>A+</u>	<u>AA+, AA, AA-</u>	<u>Aa1, Aa2, Aa3</u>	<u>AA+, AA, AA-</u>
<u>Secure – 3</u>	<u>A</u>	<u>A+, A</u>	<u>A1, A2</u>	<u>A+, A</u>
<u>Secure – 4</u>	<u>A-</u>	<u>A-</u>	<u>A3</u>	<u>A-</u>
<u>Secure – 5</u>	<u>B++, B+</u>	<u>BBB+, BBB, BBB-</u>	<u>Baa1, Baa2, Baa3</u>	<u>BBB+, BBB, BBB-</u>
<u>Vulnerable – 6</u>	<u>B, B-C++, C+, C, C-, D, E, F</u>	<u>BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R</u>	<u>Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C</u>	<u>BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD</u>

- (b) The business practices of the certified reinsurer in dealing with its ceding insurers, including its record of compliance with reinsurance contractual terms and obligations;
 - (c) For certified reinsurers domiciled in the U.S., a review of the most recent applicable NAIC Annual Statement Blank, either Schedule F (for property/casualty reinsurers) or Schedule S (for life and health reinsurers);
 - (d) For certified reinsurers not domiciled in the U.S., a review annually of Form CR-F (for property/casualty reinsurers) or Form CR-S (for life and health reinsurers) (attached as exhibits to this regulation);
 - (e) The reputation of the certified reinsurer for prompt payment of claims under reinsurance agreements, based on an analysis of ceding insurers' Schedule F reporting of overdue reinsurance recoverables, including the proportion of obligations that are more than 90 days past due or are in dispute, with specific attention given to obligations payable to companies that are in administrative supervision or receivership;
 - (f) Regulatory actions against the certified reinsurer;
 - (g) The report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in paragraph (h) below;
 - (h) For certified reinsurers not domiciled in the U.S., audited financial statements, (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the non-U.S. jurisdiction supervisor). Upon the initial application for certification, the commissioner will consider audited financial statements for the last 3 years filed with its non-U.S. jurisdiction supervisor;
 - (i) The liquidation priority of obligations to a ceding insurer in the certified reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding;
 - (j) A certified reinsurer's participation in any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers. The commissioner shall receive prior notice from a certified reinsurer that proposes participation by the certified reinsurer in a solvent scheme of arrangement; and
 - (k) Any other information deemed relevant by the commissioner.
- (5) Based on the analysis conducted under subparagraph 4(e) of a certified reinsurer's reputation for prompt payment of claims, the commissioner may make appropriate adjustments in the security the certified reinsurer is required to post to protect its liabilities to U.S. ceding insurers, provided that the commissioner shall, at a minimum, increase the security the certified

reinsurer is required to post by one rating level under subparagraph (4)(a) if the commissioner finds that

(a) more than 15% of the certified reinsurer's ceding insurance clients have overdue reinsurance recoverables on paid losses of 90 days or more which are not in dispute and which exceed \$100,000 for each cedent; or

(b) the aggregate amount of reinsurance recoverables on paid losses which are not in dispute that are overdue by 90 days or more exceeds \$50,000,000.

(6) The assuming insurer must submit a properly executed Form CR-1 (attached as an exhibit to this regulation) as evidence of its submission to the jurisdiction of this state, appointment of the commissioner as an agent for service of process in this state, and agreement to provide security for one hundred percent (100%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment. The commissioner shall not certify any assuming insurer that is domiciled in a jurisdiction that the commissioner has determined does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(7) The certified reinsurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis. All information submitted by certified reinsurers which are not otherwise public information subject to disclosure shall be exempted from disclosure under [cite state law equivalent of Freedom of Information Act] and shall be withheld from public disclosure. The applicable information filing requirements are, as follows:

(a) Notification within 10 days of any regulatory actions taken against the certified reinsurer, any change in the provisions of its domiciliary license or any change in rating by an approved rating agency, including a statement describing such changes and the reasons therefore;

(b) Annually, Form CR-F or CR-S, as applicable [per the instructions to be developed as an exhibit to this model];

(c) Annually, the report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in subsection (d) below;

(d) Annually, audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the certified reinsurer's supervisor). Upon the initial certification, audited financial statements for the last 3 years filed with the certified reinsurer's supervisor;

(e) At least annually, an updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers;

(f) A certification from the certified reinsurer's domestic regulator that the certified reinsurer is in good standing and maintains capital in excess of the jurisdiction's highest regulatory action level; and

(g) Any other information that the commissioner may reasonably require.

(8) Change in Rating or Revocation of Certification.

(a) In the case of a downgrade by a rating agency or other disqualifying circumstance, the commissioner shall upon written notice assign a new rating to the certified reinsurer in accordance with the requirements of paragraph (4)(a).

(b) The commissioner shall have the authority to suspend, revoke, or otherwise modify a certified reinsurer's certification at any time if the certified reinsurer fails to meet its obligations or security requirements under this section, or if other financial or operating results of the certified reinsurer, or documented significant delays in payment by the certified reinsurer, lead the commissioner to reconsider the certified reinsurer's ability or willingness to meet its contractual obligations.

(c) If the rating of a certified reinsurer is upgraded by the commissioner, the certified reinsurer may meet the security requirements applicable to its new rating on a prospective basis, but the commissioner shall require the certified reinsurer to post security under the previously applicable security requirements as to all contracts in force on or before the effective date of the upgraded rating. If the rating of a certified reinsurer is downgraded by the commissioner, the commissioner shall require the certified reinsurer to meet the security requirements applicable to its new rating for all business it has assumed as a certified reinsurer.

(d) Upon revocation of the certification of a certified reinsurer by the commissioner, the assuming insurer shall be required to post security in accordance with Section 10 in order for the ceding insurer to continue to take credit for reinsurance ceded to the assuming insurer. If funds continue to be held in trust in accordance with Section 7, the commissioner may allow additional credit equal to the ceding insurer's *pro rata* share of such funds, discounted to reflect the risk of uncollectibility and anticipated expenses of trust administration. Notwithstanding the change of a certified reinsurer's rating or revocation of its certification, a domestic insurer that has ceded reinsurance to that certified reinsurer may not be denied credit for reinsurance for a period of 3 months for all reinsurance ceded to that certified reinsurer, unless the reinsurance is found by the commissioner to be at high risk of uncollectibility.

C. Qualified Jurisdictions.

(1) If, upon conducting an evaluation under this Section with respect to the reinsurance supervisory system of any non-U.S. assuming insurer, the commissioner determines that the jurisdiction qualifies to be recognized as a qualified jurisdiction, the commissioner shall publish notice and evidence of such recognition in an appropriate manner. The commissioner may establish a procedure to withdraw recognition of those jurisdictions that are no longer

qualified.

- (2) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the reinsurance supervisory system of the non-U.S. jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. The commissioner shall determine the appropriate approach for evaluating the qualifications of such jurisdictions, and create and publish a list of jurisdictions whose reinsurers may be approved by the commissioner as eligible for certification. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. Additional factors to be considered in determining whether to recognize a qualified jurisdiction, in the discretion of the commissioner, include but are not limited to the following:
- (a) The framework under which the assuming insurer is regulated.
 - (b) The structure and authority of the domiciliary regulator with regard to solvency regulation requirements and financial surveillance.
 - (c) The substance of financial and operating standards for assuming insurers in the domiciliary jurisdiction.
 - (d) The form and substance of financial reports required to be filed or made publicly available by reinsurers in the domiciliary jurisdiction and the accounting principles used.
 - (e) The domiciliary regulator's willingness to cooperate with U.S. regulators in general and the commissioner in particular.
 - (f) The history of performance by assuming insurers in the domiciliary jurisdiction.
 - (g) Any documented evidence of substantial problems with the enforcement of final U.S. judgments in the domiciliary jurisdiction. A jurisdiction will not be considered to be a qualified jurisdiction if the commissioner has determined that it does not adequately and promptly enforce final U.S. judgments or arbitration awards.
 - (h) Any relevant international standards or guidance with respect to mutual recognition of reinsurance supervision adopted by the International Association of Insurance Supervisors or successor organization.
 - (i) Any other matters deemed relevant by the commissioner.
- (3) If the NAIC publishes a list of qualified jurisdictions, the commissioner may defer to this list in determining qualified jurisdictions.
- (4) U.S. jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.

D. Recognition of Certification Issued by an NAIC Accredited Jurisdiction.

- (1) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction's certification, and to defer to the rating assigned by that jurisdiction, if the assuming insurer submits a properly executed Form CR-1 and such additional information as the commissioner requires. The assuming insurer shall be considered to be a certified reinsurer in this state.
- (2) Any change in the certified reinsurer's status or rating in the other jurisdiction shall apply automatically in this State as of the date it takes effect in the other jurisdiction. The certified reinsurer shall notify the commissioner of any change in its status or rating within 10 days after receiving notice of the change.
- (3) The commissioner may withdraw recognition of the other jurisdiction's rating at any time and assign a new rating in accordance with Subparagraph B(7)(a) of this section.
- (4) The commissioner may withdraw recognition of the other jurisdiction's certification at any time, with written notice to the certified reinsurer. Unless the commissioner suspends or revokes the certified reinsurer's certification in accordance with Subparagraph B(7)(b) of this section, the certified reinsurer's certification shall remain in good standing in this State for a period of three months, which shall be extended if additional time is necessary to consider the assuming insurer's application for certification in this State.

E. Mandatory Funding Clause. In addition to the clauses required under Section 14, reinsurance contracts entered into or renewed under this section shall include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer under this section for reinsurance ceded to the certified reinsurer.

F. The commissioner shall comply with all reporting and notification requirements that may be established by the NAIC with respect to certified reinsurers and qualified jurisdictions.

Section 89. Credit for Reinsurance Required by Law

Pursuant to Section [cite state law equivalent of Section 2~~EF~~ of the Credit for Reinsurance Model Law], the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section [cite state law equivalent of Sections 2A, B, C, D, E or other appropriate section of the of the Credit for Reinsurance Model Law] but only as to the insurance of risks located in jurisdictions where the reinsurance is required by the applicable law or regulation of that jurisdiction. As used in this section, "jurisdiction" means state, district or territory of the United States and any lawful national government.

Drafting Note: Examples of assuming insurers for which credit may be allowed under this section include state owned or controlled insurance or reinsurance companies or ceding company participation in pools, guaranty associations or residual market mechanisms required by statute, regulation or administrative order.

Section 910. Asset or Reduction from Liability for Reinsurance Ceded to an Unauthorized Assuming Insurer not Meeting the Requirements of Sections 4 Through 89

A. Pursuant to Section [cite state law equivalent of Section 3 of the Credit for Reinsurance Model Law], the commissioner shall allow a reduction from liability for reinsurance ceded by a domestic insurer to an assuming insurer not meeting the

requirements of Section [cite state law equivalent of Section 2 or other appropriate section of the Credit for Reinsurance Model Law] in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the exclusive benefit of the ceding insurer, under a reinsurance contract with such assuming insurer as security for the payment of obligations under the reinsurance contract. The security shall be held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer or, in the case of a trust, held in a qualified United States financial institution as defined in Section [cite state law equivalent of Section 4B of the Credit for Reinsurance Model Law]. This security may be in the form of any of the following:

- (1) Cash;
- (2) Securities listed by the Securities Valuation Office of the NAIC, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- (3) Clean, irrevocable, unconditional and “evergreen” letters of credit issued or confirmed by a qualified United States institution, as defined in Section [cite state law equivalent of Section 4A of the Credit for Reinsurance Model Law], effective no later than December 31 of the year for which filing is being made, and in the possession of, or in trust for, the ceding ~~company~~insurer on or before the filing date of its annual statement. Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution’s subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or
- (4) Any other form of security acceptable to the commissioner.

- B. An admitted asset or a reduction from liability for reinsurance ceded to an unauthorized assuming insurer pursuant to this section shall be allowed only when the requirements of Section ~~134~~ and the applicable portions of Sections ~~101~~, ~~142~~ ~~and/or~~ ~~123~~ of this regulation have been satisfied.

Section ~~101~~. Trust Agreements Qualified under Section ~~910~~

- A. As used in this section:

- (1) “Beneficiary” means the entity for whose sole benefit the trust has been established and any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

Drafting Note: The NAIC has adopted the above definition as part of the “Uniform Letter of Credit.” However, the state may choose to utilize the following definition: “Beneficiary” includes any successor by operation of law of the named beneficiary, including without limitation any liquidator, rehabilitator, receiver or conservator.

- (2) “Grantor” means the entity that has established a trust for the sole benefit of the beneficiary. When established in conjunction with a reinsurance agreement, the grantor is the unlicensed, unaccredited assuming insurer.
- (3) “Obligations,” as used Subsection B(11) of this section means:

- (a) Reinsured losses and allocated loss expenses paid by the ceding company, but not recovered from the assuming insurer;
- (b) Reserves for reinsured losses reported and outstanding;
- (c) Reserves for reinsured losses incurred but not reported; and
- (d) Reserves for allocated reinsured loss expenses and unearned premiums.

B. Required conditions.

- (1) The trust agreement shall be entered into between the beneficiary, the grantor and a trustee, which shall be a qualified United States financial institution as defined in Section [insert citation to state law equivalent to Section 4B of the Credit for Reinsurance Model Law].
- (2) The trust agreement shall create a trust account into which assets shall be deposited.
- (3) All assets in the trust account shall be held by the trustee at the trustee's office in the United States.
- (4) The trust agreement shall provide that:
 - (a) The beneficiary shall have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice from the beneficiary to the trustee;
 - (b) No other statement or document is required to be presented to withdraw assets, except that the beneficiary may be required to acknowledge receipt of withdrawn assets;
 - (c) It is not subject to any conditions or qualifications outside of the trust agreement; and
 - (d) It shall not contain references to any other agreements or documents except as provided for in Paragraphs (11) and (12) of this subsection.
- (5) The trust agreement shall be established for the sole benefit of the beneficiary.
- (6) The trust agreement shall require the trustee to:
 - (a) Receive assets and hold all assets in a safe place;
 - (b) Determine that all assets are in such form that the beneficiary, or the trustee upon direction by the beneficiary, may whenever necessary negotiate any such assets, without consent or signature from the grantor or any other person or entity;
 - (c) Furnish to the grantor and the beneficiary a statement of all assets in the trust account upon its inception and at intervals no less frequent than the end of each calendar quarter;
 - (d) Notify the grantor and the beneficiary within ten (10) days, of any deposits to or withdrawals from the trust account;

- (e) Upon written demand of the beneficiary, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title and interest in the assets held in the trust account to the beneficiary and deliver physical custody of the assets to the beneficiary; and
 - (f) Allow no substitutions or withdrawals of assets from the trust account, except on written instructions from the beneficiary, except that the trustee may, without the consent of but with notice to the beneficiary, upon call or maturity of any trust asset, withdraw such asset upon condition that the proceeds are paid into the trust account.
- (7) The trust agreement shall provide that at least thirty (30) days, but not more than forty-five (45) days, prior to termination of the trust account, written notification of termination shall be delivered by the trustee to the beneficiary.
 - (8) The trust agreement shall be made subject to and governed by the laws of the state in which the trust is domiciled.
 - (9) The trust agreement shall prohibit invasion of the trust corpus for the purpose of paying commission to, or reimbursing the expenses of, the trustee. In order for a letter of credit to qualify as an asset of the trust, the trustee shall have the right and the obligation pursuant to the deed of trust or some other binding agreement (as duly approved by the commissioner), to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced.
 - (10) The trust agreement shall provide that the trustee shall be liable for its negligence, willful misconduct or lack of good faith. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall be deemed to be negligence and/or willful misconduct.
 - (11) Notwithstanding other provisions of this regulation, when a trust agreement is established in conjunction with a reinsurance agreement covering risks other than life, annuities and accident and health, where it is customary practice to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:
 - (a) To pay or reimburse the ceding insurer for the assuming insurer's share under the specific reinsurance agreement regarding any losses and allocated loss expenses paid by the ceding insurer, but not recovered from the assuming insurer, or for unearned premiums due to the ceding insurer if not otherwise paid by the assuming insurer;
 - (b) To make payment to the assuming insurer of any amounts held in the trust account that exceed 102 percent of the actual amount required to fund the assuming insurer's obligations under the specific reinsurance agreement; or
 - (c) Where the ceding insurer has received notification of termination of the trust account and where the assuming insurer's entire obligations under the specific reinsurance agreement remain unliquidated and

undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the obligations and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified U.S. financial institution as defined in Section [insert citation to state law equivalent of Section 4B of the Credit for Reinsurance Model Law] apart from its general assets, in trust for such uses and purposes specified in Subparagraphs (a) and (b) above as may remain executory after such withdrawal and for any period after the termination date.

(12) Notwithstanding other provisions of this regulation, when a trust agreement is established to meet the requirements of Section 910 in conjunction with a reinsurance agreement covering life, annuities or accident and health risks, where it is customary to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:

(a) To pay or reimburse the ceding insurer for:

(i) The assuming insurer's share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of the policies; and

(ii) The assuming insurer's share under the specific reinsurance agreement of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurer, under the terms and provisions of the policies reinsured under the reinsurance agreement;

(b) To pay to the assuming insurer amounts held in the trust account in excess of the amount necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer; or

(c) Where the ceding insurer has received notification of termination of the trust and where the assuming insurer's entire obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurer's share of liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer, and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified U.S. financial institution apart from its general assets, in trust for the uses and purposes specified in Subparagraphs (a) and (b) of this paragraph as may remain executory after withdrawal and for any period after the termination date.

(13) ~~The reinsurance agreement may, but need not, contain the provisions required in Subsection D(1)(b) of this section, so long as these required conditions are included in the trust agreement. Either the reinsurance agreement or the trust agreement must stipulate that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a United States bank and payable in United States dollars, and~~

investments permitted by the Insurance Code or any combination of the above, provided investments in or issued by an entity controlling, controlled by or under common control with either the grantor or the beneficiary of the trust shall not exceed five percent (5%) of total investments. The agreement may further specify the types of investments to be deposited. If the reinsurance agreement covers life, annuities or accident and health risks, then the provisions required by this paragraph must be included in the reinsurance agreement.

C. Permitted conditions.

- (1) The trust agreement may provide that the trustee may resign upon delivery of a written notice of resignation, effective not less than ninety (90) days after the beneficiary and grantor receive the notice and that the trustee may be removed by the grantor by delivery to the trustee and the beneficiary of a written notice of removal, effective not less than ninety (90) days after the trustee and the beneficiary receive the notice, provided that no such resignation or removal shall be effective until a successor trustee has been duly appointed and approved by the beneficiary and the grantor and all assets in the trust have been duly transferred to the new trustee.
- (2) The grantor may have the full and unqualified right to vote any shares of stock in the trust account and to receive from time to time payments of any dividends or interest upon any shares of stock or obligations included in the trust account. Any interest or dividends shall be either forwarded promptly upon receipt to the grantor or deposited in a separate account established in the grantor's name.
- (3) The trustee may be given authority to invest, and accept substitutions of, any funds in the account, provided that no investment or substitution shall be made without prior approval of the beneficiary, unless the trust agreement specifies categories of investments acceptable to the beneficiary and authorizes the trustee to invest funds and to accept substitutions that the trustee determines are at least equal in current fair market value to the assets withdrawn and that are consistent with the restrictions in Subsection D(1)(b) of this section.
- (4) The trust agreement may provide that the beneficiary may at any time designate a party to which all or part of the trust assets are to be transferred. Transfer may be conditioned upon the trustee receiving, prior to or simultaneously, other specified assets.
- (5) The trust agreement may provide that, upon termination of the trust account, all assets not previously withdrawn by the beneficiary shall, with written approval by the beneficiary, be delivered over to the grantor.

D. Additional conditions applicable to reinsurance agreements:

- (1) A reinsurance agreement may contain provisions that:
 - (a) Require the assuming insurer to enter into a trust agreement and to establish a trust account for the benefit of the ceding insurer, and specifying what the agreement is to cover;
 - ~~(b) Stipulate that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a~~

~~United States bank and payable in United States dollars, and investments permitted by the Insurance Code or any combination of the above, provided investments in or issued by an entity controlling, controlled by or under common control with either the grantor or the beneficiary of the trust shall not exceed five percent (5%) of total investments. The reinsurance agreement may further specify the types of investments to be deposited. Where a trust agreement is entered into in conjunction with a reinsurance agreement covering risks other than life, annuities and accident and health, then the trust agreement may contain the provisions required by this paragraph in lieu of including such provisions in the reinsurance agreement;~~

- (~~eb~~) Require the assuming insurer, prior to depositing assets with the trustee, to execute assignments or endorsements in blank, or to transfer legal title to the trustee of all shares, obligations or any other assets requiring assignments, in order that the ceding insurer, or the trustee upon the direction of the ceding insurer, may whenever necessary negotiate these assets without consent or signature from the assuming insurer or any other entity;
- (~~ec~~) Require that all settlements of account between the ceding insurer and the assuming insurer be made in cash or its equivalent; and
- (~~ed~~) Stipulate that the assuming insurer and the ceding insurer agree that the assets in the trust account, established pursuant to the provisions of the reinsurance agreement, may be withdrawn by the ceding insurer at any time, notwithstanding any other provisions in the reinsurance agreement, and shall be utilized and applied by the ceding insurer or its successors in interest by operation of law, including without limitation any liquidator, rehabilitator, receiver or conservator of such company, without diminution because of insolvency on the part of the ceding insurer or the assuming insurer, only for the following purposes:
 - (i) To pay or reimburse the ceding insurer for:
 - (I) The assuming insurer's share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement because of cancellations of such policies;
 - (II) The assuming insurer's share of surrenders and benefits or losses paid by the ceding insurer pursuant to the provisions of the policies reinsured under the reinsurance agreement; and
 - (III) Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer;
 - (ii) To make payment to the assuming insurer of amounts held in the trust account in excess of the amount necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer.

- (2) The reinsurance agreement also may contain provisions that:
- (a) Give the assuming insurer the right to seek approval from the ceding insurer, which shall not be unreasonably or arbitrarily withheld, to withdraw from the trust account all or any part of the trust assets and transfer those assets to the assuming insurer, provided:
 - (i) The assuming insurer shall, at the time of withdrawal, replace the withdrawn assets with other qualified assets having a current fair market value equal to the market value of the assets withdrawn so as to maintain at all times the deposit in the required amount; or
 - (ii) After withdrawal and transfer, the current fair market value of the trust account is no less than 102 percent of the required amount.
 - (b) Provide for the return of any amount withdrawn in excess of the actual amounts required for Paragraph (1)(e) of this subsection, and for interest payments at a rate not in excess of the prime rate of interest on ~~thesuch~~ amounts ~~held pursuant to Paragraph (1)(e) of this subsection~~;
 - (c) Permit the award by any arbitration panel or court of competent jurisdiction of:
 - (i) Interest at a rate different from that provided in Subparagraph (b) of this paragraph;
 - (ii) Court or arbitration costs;
 - (iii) Attorney's fees; and
 - (iv) Any other reasonable expenses.

~~(3)E.~~ Financial reporting. A trust agreement may be used to reduce any liability for reinsurance ceded to an unauthorized assuming insurer in financial statements required to be filed with this department in compliance with the provisions of this regulation when established on or before the date of filing of the financial statement of the ceding insurer. Further, the reduction for the existence of an acceptable trust account may be up to the current fair market value of acceptable assets available to be withdrawn from the trust account at that time, but such reduction shall be no greater than the specific obligations under the reinsurance agreement that the trust account was established to secure.

~~(4)F.~~ Existing agreements. Notwithstanding the effective date of this regulation, any trust agreement or underlying reinsurance agreement in existence prior to [insert date] will continue to be acceptable until [insert date], at which time the agreements will have to fully comply with this regulation for the trust agreement to be acceptable.

~~(5)G.~~ The failure of any trust agreement to specifically identify the beneficiary as defined in Subsection A of this section shall not be construed to affect any actions or rights that the commissioner may take or possess pursuant to the provisions of the laws of this state.

Section 142. Letters of Credit Qualified under Section 910

- A. The letter of credit must be clean, irrevocable, unconditional and issued or confirmed by a qualified United States financial institution as defined in Section [insert citation to state law equivalent of Section 4A of the Credit for Reinsurance Model Law]. The letter of credit shall contain an issue date and expiration date and shall stipulate that the beneficiary need only draw a sight draft under the letter of credit and present it to obtain funds and that no other document need be presented. The letter of credit also shall indicate that it is not subject to any condition or qualifications outside of the letter of credit. In addition, the letter of credit itself shall not contain reference to any other agreements, documents or entities, except as provided in Subsection I(1) of this section. As used in this section, “beneficiary” means the domestic insurer for whose benefit the letter of credit has been established and any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

Drafting Note: The NAIC has adopted the above definition as part of the “Uniform Letter of Credit.” However, the state may choose to utilize the following definition: “Beneficiary” includes any successor by operation of law of the named beneficiary, including without limitation any liquidator, rehabilitator, receiver or conservator.

- B. The heading of the letter of credit may include a boxed section containing the name of the applicant and other appropriate notations to provide a reference for the letter of credit. The boxed section shall be clearly marked to indicate that such information is for internal identification purposes only.
- C. The letter of credit shall contain a statement to the effect that the obligation of the qualified United States financial institution under the letter of credit is in no way contingent upon reimbursement with respect thereto.
- D. The term of the letter of credit shall be for at least one year and shall contain an “evergreen clause” that prevents the expiration of the letter of credit without due notice from the issuer. The “evergreen clause” shall provide for a period of no less than thirty (30) days notice prior to expiration date or nonrenewal.
- E. The letter of credit shall state whether it is subject to and governed by the laws of this state or the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication ~~5600~~ (UCP 600) or International Standby Practices of the International Chamber of Commerce Publication 590 (ISP98), or any successor publication, and all drafts drawn thereunder shall be presentable at an office in the United States of a qualified United States financial institution.
- F. If the letter of credit is made subject to the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 500), or any successor publication, then the letter of credit shall specifically address and provide for an extension of time to draw against the letter of credit in the event that one or more of the occurrences specified in Article 17 of Publication 500 or any other successor publication, occur.
- ~~G. The letter of credit shall be issued or confirmed by a qualified United States financial institution authorized to issue letters of credit, pursuant to Section [insert citation to state law equivalent to 4A of the Credit for Reinsurance Model Law].~~
- HG. If the letter of credit is issued by a ~~qualified United States~~ financial institution authorized to issue letters of credit, other than a qualified United States financial institution as described in Subsection GA of this section, then the following additional requirements shall be met:

- (1) The issuing ~~qualified United States~~ financial institution shall formally designate the confirming qualified United States financial institution as its agent for the receipt and payment of the drafts; and
- (2) The “evergreen clause” shall provide for thirty (30) days notice prior to expiration date for nonrenewal.

~~H~~. Reinsurance agreement provisions.

- (1) The reinsurance agreement in conjunction with which the letter of credit is obtained may contain provisions that:
 - (a) Require the assuming insurer to provide letters of credit to the ceding insurer and specify what they are to cover;
 - (b) Stipulate that the assuming insurer and ceding insurer agree that the letter of credit provided by the assuming insurer pursuant to the provisions of the reinsurance agreement may be drawn upon at any time, notwithstanding any other provisions in the agreement, and shall be utilized by the ceding insurer or its successors in interest only for one or more of the following reasons:
 - (i) To pay or reimburse the ceding insurer for:
 - (I) The assuming insurer’s share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurers, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of such policies;
 - (II) The assuming insurer’s share, under the specific reinsurance agreement, of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurers, under the terms and provisions of the policies reinsured under the reinsurance agreement; and
 - (III) Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer;
 - (ii) Where the letter of credit will expire without renewal or be reduced or replaced by a letter of credit for a reduced amount and where the assuming insurer’s entire obligations under the ~~specific~~ reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurer’s share of the liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer and exceed the amount of any reduced or replacement letter of credit, and deposit those amounts in a separate account in the name of the ceding insurer in a qualified U.S. financial institution apart from its general assets, in trust for such uses and purposes specified in Subsection ~~H~~(1)(b)(i) of this section as may remain after withdrawal and for any period after the termination date.

- (c) All of the provisions of Paragraph (1) of this subsection shall be applied without diminution because of insolvency on the part of the ceding insurer or assuming insurer.
- (2) Nothing contained Paragraph (1) of this subsection shall preclude the ceding insurer and assuming insurer from providing for:
 - (a) An interest payment, at a rate not in excess of the prime rate of interest, on the amounts held pursuant to ~~Paragraph~~ subparagraph (1)(b) of this ~~regulations~~subsection; or
 - (b) The return of any amounts drawn down on the letters of credit in excess of the actual amounts required for the above or any amounts that are subsequently determined not to be due.

Section 123. Other Security

A ceding insurer may take credit for unencumbered funds withheld by the ceding insurer in the United States subject to withdrawal solely by the ceding insurer and under its exclusive control.

Section 134. Reinsurance Contract

Credit will not be granted, nor an asset or reduction from liability allowed, to a ceding insurer for reinsurance effected with assuming insurers meeting the requirements of Sections 4, 5, 6, 7, 8 or 9 of this regulation or otherwise in compliance with Section [cite state law equivalent of Section 2 of the Credit for Reinsurance Model Law] after the adoption of this regulation unless the reinsurance agreement:

- A. Includes a proper insolvency clause, which stipulates that reinsurance is payable directly to the liquidator or successor without diminution regardless of the status of the ceding company, pursuant to Section [insert appropriate number] of the Insurance Code; ~~and~~
- B. Includes a provision pursuant to Section [cite state law equivalent to Section 2 of the Credit for Reinsurance Model Law] whereby the assuming insurer, if an unauthorized assuming insurer, has submitted to the jurisdiction of an alternative dispute resolution panel or court of competent jurisdiction within the United States, has agreed to comply with all requirements necessary to give the court or panel jurisdiction, has designated an agent upon whom service of process may be effected, and has agreed to abide by the final decision of the court or panel; ~~and~~
- C. Includes a proper reinsurance intermediary clause, if applicable, which stipulates that the credit risk for the intermediary is carried by the assuming insurer.

Drafting Note: It is recognized that credit for reinsurance may be affected by other sections of the adopting state's code, e.g., the statutory insolvency or intermediary clauses. It is recommended that states that have statutory insolvency or intermediary clauses consider incorporating those clauses into this regulation.

Section 145. Contracts Affected

All new and renewal reinsurance transactions entered into after [insert date] shall conform to the requirements of the Act and this regulation if credit is to be given to the ceding insurer for such reinsurance.

1991 Proc. I 9, 18, 908,926-927, 930-939 (adopted).
1996 Proc. 3rd Quarter 9, 41, 1109, 1111, 1112-1125 (amended and reprinted).
2001 Proc. 1st Quarter 17, 738, 862, 863-872 (amended).
2006 Proc. 2nd Quarter 40, 91-93 (amended).

Model Regulation Service—October 2007

FORM AR-1

CERTIFICATE OF ASSUMING INSURER

I, _____, _____
(name of officer) (title of officer)

of _____, the assuming insurer
(name of assuming insurer)

under a reinsurance agreement with one or more insurers domiciled in

_____, hereby certify that
(name of state)

_____, (“Assuming Insurer”):
(name of assuming insurer)

1. Submits to the jurisdiction of any court of competent jurisdiction in _____
(ceding insurer’s state of domicile)

for the adjudication of any issues arising out of the reinsurance agreement, agrees to comply with all requirements necessary to give such court jurisdiction, and will abide by the final decision of such court or any appellate court in the event of an appeal. Nothing in this paragraph constitutes or should be understood to constitute a waiver of Assuming Insurer’s rights to commence an action in any court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States. This paragraph is not intended to conflict with or override the obligation of the parties to the reinsurance agreement to arbitrate their disputes if such an obligation is created in the agreement.

2. Designates the Insurance Commissioner of _____
(ceding insurer’s state of domicile)

as its lawful attorney upon whom may be served any lawful process in any action, suit or proceeding arising out of the reinsurance agreement instituted by or on behalf of the ceding insurer.

3. Submits to the authority of the Insurance Commissioner of _____ to examine
(ceding insurer’s state of domicile)

its books and records and agrees to bear the expense of any such examination.

4. Submits with this form a current list of insurers domiciled in _____
(ceding insurer’s state of domicile)

reinsured by Assuming Insurer and undertakes to submit additions to or deletions from the list to the Insurance Commissioner at least once per calendar quarter.

Dated: _____
(name of assuming insurer)

BY: _____
(name of officer)

(title of officer)

Credit for Reinsurance Regulation

FORM ACR-1CERTIFICATE OF ASSUMING CERTIFIED REINSURER

I, _____, _____
(name of officer) (title of officer)

of _____, the assuming insurer
(name of assuming insurer)

under a reinsurance agreement with one or more insurers domiciled in

_____, in order to be considered for approval in this state. hereby certify that

(name of state)

_____, (“Assuming Insurer”):
(name of assuming insurer)

1. Submits to the jurisdiction of any court of competent jurisdiction in _____
(ceding insurer’s state of domicile)

for the adjudication of any issues arising out of the reinsurance agreement, agrees to comply with all requirements necessary to give such court jurisdiction, and will abide by the final decision of such court or any appellate court in the event of an appeal. Nothing in this paragraph constitutes or should be understood to constitute a waiver of Assuming Insurer’s rights to commence an action in any court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States. This paragraph is not intended to conflict with or override the obligation of the parties to the reinsurance agreement to arbitrate their disputes if such an obligation is created in the agreement.

2. Designates the Insurance Commissioner of _____
(ceding insurer’s state of domicile)

as its lawful attorney upon whom may be served any lawful process in any action, suit or proceeding arising out of the reinsurance agreement instituted by or on behalf of the ceding insurer.

~~3. Submits to the authority of the Insurance Commissioner of _____ to examine
its books and records and agrees to bear the expense of any such examination.
(ceding insurer’s state of domicile)~~

~~4. Submits with this form a current list of insurers domiciled in _____
(ceding insurer’s state of domicile)
reinsured by Assuming Insurer and undertakes to submit additions to or deletions from the list to the Insurance
Commissioner at least once per calendar quarter.~~

~~3. Agrees to provide security in an amount equal to 100% of liabilities attributable to U.S. ceding insurers if it
resists enforcement of a final U.S. judgment or properly enforceable arbitration award.~~

~~4. Agrees to provide notification within 10 days of any regulatory actions taken against it, any change in the
provisions of its domiciliary license or any change in its rating by an approved rating agency, including a
statement describing such changes and the reasons therefore.~~

~~5. Agrees to annually file information comparable to relevant provisions of the NAIC financial statement for use
by insurance markets in accordance with [cite relevant provision of the state equivalent of the Credit for
Reinsurance Model Regulation.]~~

~~6. Agrees to annually file the report of the independent auditor on the financial statements of the insurance
enterprise.~~

~~7. Agrees to annually file audited financial statements, regulatory filings, and actuarial opinion in accordance
with [cite relevant provision of the state equivalent of the Credit for Reinsurance Model Regulation.]~~

8. Agrees to annually file an updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers.

9. Is in good standing as an insurer or reinsurer with the supervisor of its domiciliary jurisdiction.

Dated: _____

(name of assuming insurer)

BY: _____
(name of officer)

PROJECT HISTORY

REVISIONS TO THE CREDIT FOR REINSURANCE MODEL LAW (#785) AND REGULATION (#786)

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

Under the current NAIC Credit for Reinsurance Model Law & Regulation, in order for U.S. ceding companies to receive reinsurance credit, the reinsurance must either be ceded to U.S. licensed reinsurers or secured by collateral representing 100% of U.S. liabilities for which the credit is recorded. The collateral requirements for non-U.S. licensed reinsurers have been a frequent subject of debate over the past decade, with various groups calling for the elimination of the collateral requirement for reinsurers licensed in well-regulated jurisdictions. On September 19, 2011, both the Reinsurance (E) Task Force and Financial Condition (E) Committee adopted revisions to the *Credit for Reinsurance Model Law (#785) and Regulation (#786)* at a meeting held in Jersey City, New Jersey. These amendments will act to reduce reinsurance collateral requirements for non-U.S. reinsurers domiciled in qualified jurisdictions, and will be up for consideration by NAIC Executive (EX) Committee and Plenary at the Fall National Meeting in Washington, D.C.

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

The Reinsurance Task Force of the Financial Condition (E) Committee was responsible for drafting the revisions to the Credit for Reinsurance Models:

Thomas B. Considine, Chair	New Jersey	John M. Huff	Missouri
James J. Wrynn, Vice Chair	New York	Bruce R. Ramge	Nebraska
Jim L. Ridling	Alabama	Amy Parks	Nevada
Christina Urias	Arizona	Roger A. Sevigny	New Hampshire
Jay Bradford	Arkansas	John G. Franchini	New Mexico
Dave Jones	California	John D. Doak	Oklahoma
Thomas B. Leonardi	Connecticut	Michael F. Consedine	Pennsylvania
Karen Weldin Stewart	Delaware	Ramón Cruz-Colón	Puerto Rico
Kevin M. McCarty	Florida	Joseph Torti III	Rhode Island
Gordon I. Ito	Hawaii	David Black	South Carolina
Jack Messmore	Illinois	Neal T. Gooch	Utah
Stephen W. Robertson	Indiana	Stephen W. Kimbell	Vermont
James J. Donelon	Louisiana	Jacqueline K. Cunningham	Virginia
Eric A. Cioppa	Maine	Mike Kreidler	Washington
Mike Rothman	Minnesota	Ted Nickel	Wisconsin

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

This Project History supplements the Project History for the Reinsurance Regulatory Modernization Framework, which is attached hereto and incorporated by reference. The Task Force received charges in both 2009 and 2010 to “promote and facilitate the implementation of the adopted Reinsurance Regulatory Modernization Framework.” The project was specifically authorized in 2011 when the Task Force received the following charge: “Consider amendments to the *Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786)* to incorporate key elements of the Reinsurance Regulatory Modernization Framework.” The Executive (EX) Committee approved the model law request for revising the Model #785 and Model #786 at the 2010 Fall 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

The NAIC adopted the Reinsurance Regulatory Modernization Framework (“Framework”) at its Winter 2008 National Meeting as the first step in an effort to facilitate cross-border reinsurance transactions and enhance competition within the U.S. market, while ensuring that U.S. insurers and policyholders are adequately protected against the risk of insolvency. The Framework recommended implementation through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation of this

legislation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation.

On September 15, 2009, the Reinsurance Task Force adopted the Reinsurance Regulatory Modernization Act of 2009, which was approved on September 23, 2009, by the NAIC Government Relations Leadership Council. This proposed federal legislation was based on the Framework, and underwent an extensive review process. The Task Force released drafts of the proposed federal legislation to the public on March 24, July 27 & September 3, 2009, and the legislation was extensively revised based upon comments received from regulators and interested parties. The Task Force also held an open forum in New York on May 6-7, 2009, to receive public comments on the legislation, in addition to the numerous opportunities for public comment that were afforded during the drafting of the Framework.

The NAIC was unable to find a sponsor for the federal legislation in Congress, and it did not receive passage. Instead, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which was signed into law on July 21, 2010. This act includes the Nonadmitted and Reinsurance Reform Act (“NRRRA”), as well as creates the Federal Insurance Office (“FIO”). The NRRRA prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit and is either (1) an NAIC-accredited state; or (2) has financial solvency requirements substantially similar to NAIC accreditation requirements. This permitted the NAIC to move forward with individual state-based reinsurance collateral reduction reforms.

The revisions to the Credit for Reinsurance Models were drafted by the Task Force through a deliberate process that included two exposure periods and consideration of voluminous comments submitted by interested parties representing U.S. ceding insurers, non-U.S. reinsurers and regulators. Much of the actual drafting of the language within the proposal was undertaken during regulator-to-regulator sessions due to discussion of company specific information and consultation with NAIC staff. The Task Force considered comments from interested parties related to each of these exposure drafts in order to further develop and refine the revisions. In many cases, specific concepts or specific language recommended by interested parties has been included within the revisions, as deemed appropriate by the Task Force. In addition, the Task Force considered information that it received from various international regulators.

The Reinsurance Task Force further adopted a Preface to the Credit for Reinsurance Models on September 19, 2011. The Preface is a statement by the Task Force of the next steps to be taken after the adoption of the revised models, including (1) a proposal to form a new group to provide high quality review of reinsurance collateral reduction applications and assistance to the states; (2) consider reinsurance diversification and notification requirements for ceding insurers; (3) requirements for NAIC review and approval of qualified jurisdiction; and (4) a re-examination of the collateral requirements within two years after the effective date of the revised Credit for Reinsurance Models.

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 February 22, 2011, the Task Force released exposure drafts of revisions to Model #785 and Model #786 for a 30-day comment period. The Task Force received several comment letters from interested parties and discussed these drafts on March 26 during the Spring National Meeting in Austin, Texas. The Task Force then held an interim meeting in Jersey City, New Jersey on July 11 and took public testimony from interested parties on the proposed amendments. On July 26, the Task Force released a second set of proposed amendments to the Credit for Reinsurance Models, which were exposed for a 30-day public comment period ending on August 24. The Task Force and Financial Condition (E) Committee adopted these drafts at a meeting in Jersey City, New Jersey on September 19, with additional amendments made during each meeting (discussion following). Some of the major revisions to the models include:

- Each state will have the authority to certify reinsurers, or a commissioner has the authority to recognize the certification issued by another NAIC-accredited state. This eliminates the need for a reinsurer to be evaluated by each and every state, but preserves a commissioner’s right to do so.
- Reinsurers are subject to certain criteria in order to be eligible for certification, as well as ongoing requirements in order to maintain certification. Examples of evaluation criteria include, but are not limited to, financial strength, timely claims payment history, and the requirement that a reinsurer be domiciled and licensed in a “qualified jurisdiction.”

- Each state may evaluate a non-U.S. jurisdiction in order to determine if it is a “qualified jurisdiction.” The state may also defer to an NAIC list of recommended qualified jurisdictions.
- A certified reinsurer will be eligible for collateral reduction with respect to contracts entered into or renewed subsequent to certification [Note: clarification added in September 19 amendments]. A state will evaluate a reinsurer that applies for certification, and will assign a rating based on the evaluation. A certified reinsurer will be required to post collateral in an amount that corresponds with its assigned rating (0%, 10%, 20%, 50%, 75% or 100%), in order for a U.S. ceding insurer to be allowed full credit for the reinsurance ceded. Note: in the July 26 revisions, the collateral/rating matrix was changed with regard to companies with A- financial strength ratings, and a new Secure 4 tier was added for A- rating at 50% collateral.
- A certified reinsurer is allowed to utilize a multiple-beneficiary trust account for the purposes of securing its obligations to U.S. ceding insurers, but it must be separate from any existing multiple-beneficiary trust account.
- Proportional credit will still be permitted if there is insufficient security provided by a certified reinsurer. Specific provisions are also included to address a change in, or revocation of, the certified reinsurer’s status.
- Contracts entered into by certified reinsurers are subject to certain mandatory contract clauses in order for a U.S. ceding insurer to be allowed credit for the reinsurance ceded.
- Certified reinsurers are subject to additional filing requirements, including but not limited to new forms CR-1, CR-F and CR-S.
- The revised models also include proposed changes with respect to the trustee surplus requirement for a multiple-beneficiary trust account maintained by an assuming insurer in run-off (Tawa proposal).
- Finally, technical amendments were incorporated into the models revising language that had grown outdated and needed updating.

On September 19, 2011, both the Task Force and Financial Condition (E) Committee adopted additional revisions to the Credit for Reinsurance Models, but the amendments made during this meeting were not exposed for a public comment period. However, each of the revisions addressed issues that had been substantively debated by both the Task Force and interested parties over the previous years during discussions regarding the Framework and proposed federal legislation, as well as the revisions to the models. These revisions can be summarized as follows:

- Prospective Application. The Task Force adopted an amendment intended for clarification and to close a perceived loophole with respect to the effective date of the revised reinsurance collateral requirements, and to confirm that any potential collateral reductions would be phased-in as any future reductions would be done on a prospective basis and any prior liabilities would remain secured at 100% collateral.
- PCI/RAA Compromise. The Task Force adopted amendments related to a compromise proposal submitted by the Property Casualty Insurers Association of America (“PCI”) and the Reinsurance Association of America (“RAA”) regarding 4 important issues: (1) 30-day comment period on application for certified reinsurer status; (2) slow payment analysis of reinsurers; (3) financial statement reporting requirements for certified reinsurers and applicants for certification; and (4) disclosure of reinsurance counterparty information on new forms CR-S and CR-F. The specific amendments adopted as part of the PCI/RAA compromise include:
 1. Information will be provided with respect to how interested parties may specifically respond/comment on applications for certified reinsurers during a 30-day notice period. However, this should not trigger any Administrative Procedures Act requirements;

2. The reputation of the certified reinsurer for prompt payment of claims under reinsurance agreements will now be based specifically on an analysis of cedents' Schedule F reporting of overdue reinsurance recoverables, and may increase collateral requirements in certain specified situations;
3. Certified Reinsurers must submit audited financial statements, and, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company are acceptable;
4. Certified reinsurers must submit Forms CR-S or CR-F, at a level of detail in accordance with instructions to be developed by the NAIC.

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

- Federal v. State Implementation. The Framework recommended implementation through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation of this legislation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation. The NAIC was unable to find congressional sponsorship for this proposed federal legislation. The Nonadmitted and Reinsurance Reform Act, which became effective July 21, 2011, preempts the extraterritorial application of state credit for reinsurance law, and now permits states to proceed forward with reinsurance collateral reforms on an individual basis if they are accredited.
- Federal Insurance Office. The Dodd-Frank Act established the FIO to receive information on the insurance sector from the NAIC and enter into binding "covered agreements" with international bodies. It is widely understood that reinsurance collateral may be an initial subject of these agreements. The Dodd Frank Act allows the office in Treasury to preempt a state insurance measure to the extent that it (1) results in less favorable treatment of a non-U.S. insurer domiciled in a foreign jurisdiction that is subject to a covered agreement than a U.S. insurer domiciled, licensed, admitted, or otherwise authorized in that state; and (2) is inconsistent with such covered agreement.
- Individual State Initiatives. Some states have begun moving forward with individual state-based reinsurance collateral reforms. Florida adopted changes to its credit for reinsurance laws and regulations in 2007 and 2008 respectively, New York adopted similar changes in November 2010, and New Jersey and Indiana recently enacted similar legislation as well. In addition, bills have been discussed in Illinois, Texas and Louisiana, as well as other states. In response, the NAIC Plenary approved the Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes in December 2010.
- Requirements for Certified Reinsurers. The Task Force addressed what requirements an assuming insurer must meet in order to be approved as a certified reinsurer, and the specific information that certified reinsurers should be required to file, including questions regarding proposed schedules CR-F and CR-S as well as financial statements.
- Reciprocity. The NAIC Reinsurance Supervision Review Department (RSRD) Proposal in 2007 proposed a mutual recognition framework that would take into consideration the reciprocal treatment of non-U.S. jurisdictions. At the request of interested parties, the NAIC Legal Division issued a memorandum addressing the constitutional issues of the mutual recognition framework on July 15, 2008. The Framework adopted in December of 2008 provided that the reciprocal treatment of non-U.S. reinsurers would be a factor to be considered in the review of non-U.S. jurisdictions. The model regulation considers mutual recognition to be a factor in reviewing non-U.S. jurisdictions.
- Concentration of Risk. The Task Force considered restrictions to limit concentration risk by a ceding insurer to any reinsurer or group of reinsurers. The Task Force will make a referral to E Committee to address this issue.

- Life Reinsurance & Other Long Tail Contracts. The Task Force considered whether special limitations should be placed on life insurance and other longer tail-types of reinsurance agreements. The Reinsurance Framework Proposal originally included a 2-year moratorium on collateral reduction to life contracts, but the revised models no longer include this distinction.
- Reconciliation to U.S. GAAP. The Task Force considered the accounting and reporting basis that would be applicable to financial statements filed by certified reinsurers. Earlier versions of the models required financial statements to be filed on an audited U.S. GAAP basis, or on an IFRS basis with an audited reconciliation to U.S. GAAP for equity and net income. At the September 19 meetings, an amendment was adopted to allow audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company, with the permission of the state insurance commissioner.
- Prospective Application of Revisions. During the course of drafting the Framework and model revisions, the Task Force has consistently taken the position that any potential collateral reductions would be phased-in as any future reductions would be done on a prospective basis and any prior liabilities would remain secured at 100% collateral. Property and Casualty ceding insurers were strongly opposed to permitting reinsurance collateral under existing reinsurance agreements to be reduced or eliminated. Reinsurers and some ceding insurers would like to be able to amend existing agreements to reduce collateral requirements. At the September 19, 2011 meetings the Task Force adopted an amendment intended for clarification and to close a perceived loophole with respect to the effective date of the revised reinsurance collateral requirements.

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

In December 2010, the NAIC Plenary approved the Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes (Accreditation Recommendations), which are the key elements of the Reinsurance Regulatory Modernization Framework that should be considered in reviewing any individual state initiatives with respect to reinsurance collateral reduction reforms. The Accreditation Recommendations were intended as an interim solution to guide the Financial Regulation Standards and Accreditation (F) Committee and the NAIC during the transition period between adoption of the Framework and proposed revisions to the reinsurance models.

The revisions, if adopted, would become part of the Credit for Reinsurance Models, and would be considered by the Financial Regulation Standards and Accreditation (F) Committee as an amendment to the existing standard for Reinsurance Ceded. It should also be noted that the proposed revisions to the models would not require a state to reduce its reinsurance collateral requirements. It is further the recommendation of the Task Force that it is necessary to expeditiously modify these standards in accordance with the Procedure for the Adoption of Additional Model Laws, Regulations or Standards for Accreditation.

PROJECT HISTORY

REINSURANCE REGULATORY MODERNIZATION FRAMEWORK

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

The Reinsurance Regulatory Modernization Framework proposal is a conceptual framework that has been developed by the Reinsurance (E) Task Force in response to its charges to consider the current collateralization requirements regarding unauthorized reinsurers, and to consider the design of a revised U.S. reinsurance regulatory framework. The modernization framework is intended to facilitate cross-border reinsurance transactions and enhance competition within the U.S. market, while ensuring that U.S. insurers and policyholders are adequately protected against the risk of insolvency.

Principle components include:

- Single state supervision of U.S. reinsurers, and single state certification of non-U.S. reinsurers - The proposed framework would provide for two new classes of reinsurers in the U.S.: national reinsurers (U.S.) and port of entry (POE) reinsurers (non-U.S.). Uniform minimum standards would apply in order for a reinsurer to qualify for the national or POE classification. In order to transact assumed reinsurance business in the U.S., national reinsurers would be licensed through a single “home state,” while POE reinsurers would be certified through a single “POE state.” It is important to note that this framework would be an overlay on the existing credit for reinsurance laws. Therefore, reinsurers would have the option of continuing to operate in accordance with the current model credit for reinsurance law.
- Supervisory recognition - The proposed framework would provide for the establishment of the NAIC Reinsurance Supervision Review Department (RSRD). The RSRD would be responsible for evaluating the regulatory regimes of non-U.S. jurisdictions using an “outcomes oriented” approach. The RSRD would determine which jurisdictions are eligible to be recognized by a POE supervisor, and determine the appropriate recognition approach for such jurisdictions. The RSRD would also be responsible for establishing uniform standards for a state to qualify as either a home state supervisor or POE supervisor.
- Collateral requirements based on assigned supervisory ratings - Home state and POE supervisors would be responsible for evaluating their respective national and POE reinsurers to establish an appropriate supervisory rating. A national or POE reinsurer’s collateral requirements for contracts entered into or renewed under the framework would be determined by its assigned supervisory rating. The collateral reductions presented within this proposal would apply only to contracts inception or renewed under this framework.

As this proposal represents a conceptual framework, significant details remain to be developed during the implementation phase of this reinsurance regulatory modernization effort. These details will be developed through a deliberate and inclusive process, in the same manner as the drafting process for this framework proposal.

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

Reinsurance (E) Task Force: New Jersey (chair), Alabama, Arizona, Arkansas, California, Connecticut, Delaware, District of Columbia, Florida, Georgia, Illinois, Iowa, Kentucky, Maine, Massachusetts, Minnesota, Nebraska, Nevada, New Hampshire, New York, North Dakota, South Carolina, Texas, Vermont, Virginia, Washington, West Virginia, and Wisconsin.

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

The collateral requirements for non-U.S. licensed reinsurers have been a frequent subject of debate within the Task Force. In 2005 the Task Force published the U.S. Reinsurance Collateral White Paper (adopted by the NAIC membership in January 2006), which provided a balanced synopsis of the historical arguments in favor of and against amending U.S. reinsurance collateral requirements. On September 27, 2005, the Reinsurance Collateralization Roundtable (an ad hoc group consisting of insurance regulators and industry representatives) issued its Report of the Co-Chairs to the Task Force, in which it informally recommended that (1) the current U.S. system of requiring 100% collateral should be changed; and (2) any new U.S. rules should be “geographically agnostic” (i.e., they should apply to all reinsurers operating in the U.S. regardless of the country of domicile). During the Joint

Meeting of the NAIC Executive Committee/Plenary on March 5, 2006, the following charge to the Task Force was adopted:

“The Reinsurance (E) Task Force is directed to develop alternatives to the current reinsurance regulatory framework, including the use of collateral within the U.S. and abroad. Consider approaches that account for a reinsurer’s financial strength regardless of domicile, i.e., state or country. Identify and consider variations in state law and regulation relative to reinsurance contracts, financial reporting, etc. As part of its deliberations, the Task Force should consult with international regulators in addition to all other interested parties. The Task Force shall present the proposal to the membership by the December 2006 national meeting.”

On December 4, 2006, the Task Force adopted the NAIC Reinsurance Evaluation Office Proposal to Grant Credit for Ceded Reinsurance (“REO Proposal”), which would have created an organization called the Reinsurance Evaluation Office (“REO”) to rate the financial strength of reinsurers doing business in the U.S., irrespective of the reinsurer’s country of domicile. The E Committee charged the Task Force to re-evaluate reinsurance regulation beyond the REO Proposal and consider the design of a revised U.S. reinsurance regulatory framework. On September 7, 2007, the Task Force released for comments the “NAIC Reinsurance Supervision Review Department Draft Proposal to Grant Recognition of Regulatory Equivalence to Non-U.S. Insurance Supervisors.” The Task Force also released the accompanying “Port Of Entry State Criteria For Reinsurers Supervised in Jurisdictions Approved by the NAIC Reinsurance Supervision Review Department and U.S. Licensed Reinsurers.” These two documents were collectively referred to as the “RSRD Proposal.” At the Winter 2007 National Meeting, the Task Force and E Committee adopted a memo dated December 2, 2007, that was based on the initial “RSRD Proposal.” This memo provided an initial outline of the conceptual modernization framework and a list of outstanding issues to be addressed during the drafting process. This memo was adopted by the Plenary during the Spring 2008 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

The framework proposal was drafted by the Task Force through a deliberate process that included numerous exposure periods and consideration of voluminous comments submitted by interested parties. Much of the actual drafting of the language within the proposal was undertaken during regulator-to-regulator sessions due to discussion of company specific information and consultation with NAIC staff. However, from November 2007 through September 2008, the Task Force exposed seven drafts of the proposal for public comment as a result of these meetings. The Task Force considered comments from interested parties related to each of these exposure drafts in order to further develop and refine the framework proposal. The proposal and related comments were discussed with interested parties throughout 2008 during National and interim public meetings. In many cases, specific concepts or specific language recommended by interested parties has been included within the proposal, as deemed appropriate by the Task Force. In addition, the Task Force considered information that it received from various international regulators.

The Task Force will coordinate with other NAIC groups as appropriate as further details are developed during the implementation phase of this framework proposal.

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)

December 2006 – The Task Force adopted the REO Proposal on December 4, 2006, in an effort to address the collateral issue. Subsequently, the Task Force was charged to go beyond the REO Proposal and consider the design of a revised U.S. reinsurance regulatory framework. The issue was discussed during National Meetings and at several interim regulator-to-regulator meetings throughout 2007 as the initial “RSRD Proposal” described in Section 3 above was drafted.

September 2007 - An exposure draft recommendation of the initial “RSRD Proposal” was exposed for comment by the Task Force in September 2007. Comments were received from interested parties prior to the Fall 2007 National Meeting in Washington, D.C. The issue and related comments were discussed during this meeting on September 29, 2007; however, at the request of interested parties, the comment deadline was extended beyond the National Meeting to allow for a 45-day comment period on the exposure draft of these initial concepts.

November 2007 - The Task Force held an interim public meeting on November 7-8, 2007, in Atlanta, GA, to discuss comments received from interested parties regarding the exposure draft. During this meeting, the Task Force heard comments from interested parties and discussed primary concepts and outstanding issues related to the modernization framework. A memo dated November 8, 2007, including these concepts and issues was drafted by NAIC staff for discussion during this meeting and was subsequently exposed for comment.

December 2007 – The November 8, 2007, memo was discussed on December 2, 2007, during the Winter National Meeting in Houston, TX. After minor modification, the Task Force adopted the December 2, 2007 framework memo during this meeting. This framework memo was adopted by the E-Committee during the Winter 2007 National Meeting and by the Plenary during the Spring 2008 National Meeting in Orlando, FL.

March 2008 – The Task Force held a regulator-to-regulator meeting on March 11-12, 2008, to discuss interested parties comments and further develop the initial framework presented in the December 2, 2007 memo. As a result of this meeting, the Task Force exposed an updated draft on March 19, 2008. Though this draft was discussed during the Spring 2008 National Meeting in Orlando, FL, the Task Force extended the comment deadline and accepted comments subsequent to the Spring Meeting.

May 2008 – The Task Force held a regulator-to-regulator meeting on May 7-9, 2008, to discuss comments from interested parties on the March 19 draft, and further develop the framework proposal. The Task Force exposed an updated draft proposal on May 16, 2008, and this draft was discussed during the Summer 2008 National Meeting in San Francisco, CA. The Task Force accepted comments on this draft subsequent to the Summer Meeting.

June 2008 – The Task Force held a regulator-to-regulator meeting on June 25-27, 2008, to discuss interested parties comments on the May 16 draft, and further develop the framework proposal. The Task Force exposed an updated draft proposal on July, 3, 2008.

July 2008 – The Task Force held an interim public meeting on July 23-24, in New York, NY. During this meeting, the Task Force heard comments from interested parties and discussed the framework proposal. At the conclusion of this meeting, the Task Force requested that interested parties submit any recommendations for specific language related to core issues or concerns that were expressed during the meeting. The Task Force expressed its intention to finalize the proposal within the next few weeks and adopt a final proposal for presentation to the E Committee during the Fall 2008 National Meeting. Subsequent to the public meeting, the Task Force held a regulator-to-regulator meeting on July 24-25 to discuss the comments expressed by interested parties and further develop the framework proposal.

August 2008 – The Task Force held an interim regulator-to-regulator meeting via conference call on August 15, 2008, to discuss comments received from interested parties subsequent to the July 23-24 meeting and further develop the framework proposal. The Task Force exposed an updated draft proposal on August 20, 2008.

September 2008 – The Task Force held an interim public meeting via conference call on September 9, 2008, to hear comments from interested parties on the August 20, 2008 draft and further discuss the framework proposal. Subsequent to this meeting, the Task Force held interim regulator-to-regulator meetings via conference call on September 9 and 11, 2008, to discuss interested parties' comments and further develop the proposal. The Task Force exposed an updated framework proposal on September 12, 2008. The Task Force requested comments on new issues or the most recent modifications by September 17, but accepted written comments up to September 19, 2008. The Task Force met during the Fall 2008 National Meeting on September 22, 2008 in Washington, D.C. During this meeting, the Task Force heard comments from interested parties and discussed the framework proposal. No further modifications were made to the proposal during this meeting. The Task Force adopted the framework proposal during this meeting, with only Wisconsin opposed. On September 24, 2008, the E Committee adopted the framework proposal, with only Ohio opposed.

Upon the Plenary's adoption of this framework proposal, it is intended that the Task Force will begin another deliberate, open and inclusive process to develop the details that will be required to move this framework forward through the implementation phase. There will be ample opportunity for consideration, comment and discussion as the Task Force works to develop these details. The Task Force will coordinate with other NAIC groups as appropriate during this process.

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

- **Constitutionality of Mutual Recognition Framework.** Interested parties raised legal issues relating to the “RSRD Proposal,” which had been released for comments on September 7, 2007. Specifically, three areas of concern were identified by the interested parties: (1) traditional equivalence principles would require that unequal treatment and other burdens on companies should not be imposed simply based on their geographic location; (2) the RSRD's mutual recognition framework was unconstitutional because the states cannot enter into mutual recognition agreements with a foreign power; and (3) the RSRD Proposal is impracticable because it would not be adopted unanimously by the states, which is necessary in order for the proposal to work.

The NAIC Legal Division evaluated the legal issues raised by the interested parties, specifically with respect to the constitutionality of a state-based approach under which states would enter into mutual recognition agreements with non-U.S. jurisdictions. The Legal Division reached the following conclusions:

- While the different reinsurance collateral requirements for U.S.-national reinsurers and non-U.S. port of entry reinsurers might be argued to violate the National Treatment obligation under the General Agreement on Trade in Services (GATS), this disparate treatment would be found to be permissible because there are identifiable and meaningful differences between U.S. regulatory schemes and those non-U.S. regulatory schemes that are deemed to be “effective” by the RSRD;
- The certification of non-U.S. jurisdictions on regulatory effectiveness by the RSRD is constitutionally permissible under the Compact Clause, even in the absence of Congressional consent;
- To the extent that mutual recognition under the RSRD Proposal would involve states (or the RSRD) directly negotiating and entering into mutual recognition agreements with foreign countries to achieve reciprocal recognition by facilitating the entry of U.S. companies into foreign markets, it called into question whether the mutual recognition framework would be invalid under the Compact Clause, in the absence of Congressional consent.

A federal implementation approach was then agreed upon, which would facilitate incorporation of the concepts of mutual recognition and reciprocity into the Framework Proposal by eliminating any legal concerns with respect to inclusion of these concepts under a state-based implementation approach.

- **Disparate collateral requirements for U.S. vs. non-U.S. reinsurers.** Representatives of non-U.S. reinsurers have advocated equal treatment of high quality and well-regulated reinsurers in an environment free from collateral by regulation. Absent the complete removal of regulatory collateral requirements, non-U.S. representatives have advocated the removal of disparate treatment on the basis of domiciliary jurisdiction, and have recommended that any collateral requirements be based on the strength and reliability of a respective reinsurer.

The Task Force has noted that the proposed five-tier collateral calibration matrix is a prudent yet substantial initial step in the modernization effort. Under the current proposal, U.S. reinsurers rated in the top three tiers would be exempt from collateral requirements while non-U.S. reinsurers in the 2nd and 3rd tiers would be subject to 10% and 20% collateral requirements respectively. As a basis for this disparity, the Task Force has highlighted the fact that U.S. domiciled reinsurers are required to maintain capital in the U.S. well in excess of 100% of their reinsurance liabilities in order to meet U.S. licensing standards and Risk Based Capital requirements. In addition, U.S. reinsurers are subject to prudential U.S. reinsurance regulatory requirements designed to protect policyholders and ensure the solvency of U.S. ceding companies. The initial collateral levels will be evaluated within two years of the first full year of operations under this framework. These initial levels can be adjusted up or down as the framework evolves and as relationships with non-U.S. jurisdictions develop.

- **Reliance on financial strength ratings issued by Nationally Recognized Statistical Rating Organizations (NRSRO).** Concern has been expressed regarding the use of ratings issued by NRSROs within the reinsurer evaluation process. Concern has also been expressed regarding the difficulty that a reinsurer may have in posting any additional collateral that might be required as the result of a rating downgrade.

The Task Force acknowledges that financial strength ratings will indeed be considered during the reinsurer evaluation process. However, it is noted that such a rating is only one of many factors considered during this process, and would be used as a starting point rather than as a de facto rating. The lowest financial strength rating issued to a reinsurer does establish the maximum supervisory rating that the respective reinsurer can attain, but the supervisory rating can go down based on the consideration of several other factors. These factors include: compliance with reinsurance contractual terms and obligations, business practices of the reinsurer in dealing with ceding companies, financial reports and information, record of payment history, regulatory actions, audit opinion, jurisdictional considerations, participation in solvent schemes of arrangement or similar procedures and other information deemed relevant. The presence of a financial strength rating signifies that a reinsurer is a serious player in the reinsurance market, and indicates that continuous analysis is being performed by a party other than the regulator.

During the development of this proposal, the Task Force has given tremendous consideration to the fact that U.S. regulators' primary responsibility is to protect policyholders and ensure the solvency of U.S. ceding companies. The framework includes many provisions to facilitate regulators in this endeavor. At the core of the proposal is the premise that a reinsurer's ability to operate within this system is a privilege to be granted. Failure to fulfill reinsurance obligations or otherwise meet the requirements of this proposal will result in this privilege being withdrawn. Reinsurers who fail to meet the provisions of this proposal will immediately be required to meet the collateral provisions within the current model credit for reinsurance law. Recognition agreements with non-U.S. jurisdictions also provide substantial incentive for such jurisdictions to ensure that their respective reinsurers appropriately fulfill their obligations to U.S. ceding companies and meet the requirements of this proposal.

- **Life Insurance Industry Issues.** Life insurance industry representatives have commented that implementation of the collateral reductions within this proposal would be extremely detrimental to the U.S. life insurance industry in the absence of meaningful and comprehensive life reserve reforms. Current collateral requirements somewhat offset disparate capital and reserve requirements for U.S. vs. non-U.S. life insurers.

In an effort to better coordinate the collateral reductions included in this proposal with the life insurance reserve reform efforts currently in process, this proposal would not be applicable to life reinsurance contracts until the earlier of 24 months from the implementation of this proposal, or the implementation of U.S. principles based reserving standards for life insurance. The Task Force will continue to monitor the PBR project and consider the appropriateness of this deferral period.

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

In order to preserve state-based regulation of reinsurance on a cross-border basis, promote uniformity of regulation throughout the NAIC member jurisdictions, and in light of the opportunity presented in the related federal legislation, the Reinsurance Task Force has recommended federal enabling legislation to implement this state-based regulatory system. This federal legislation would provide appropriate authority to the RSRD, which would establish the requirements under which home state and POE supervisors would regulate national or POE reinsurers. State legislatures will be involved in passing legislation authorizing an insurance department to act as a Port of Entry or Home State supervisor. A federal approach will also facilitate incorporation of the concepts of mutual recognition and reciprocity into the framework by eliminating any legal concerns with respect to inclusion of these concepts under a state-based implementation approach. Congressional approval will allow POE supervisors (or the RSRD) to negotiate reciprocal recognition for reinsurers licensed and domiciled in the U.S.

Report of the Financial Regulation Standards and Accreditation (F) Committee

The Financial Regulation Standards and Accreditation (F) Committee met Nov. 2, 2011, in regulator-to-regulator session pursuant to Item #7 of the NAIC Policy Statement on Open Meetings. During this meeting, the Committee discussed state-specific accreditation issues and voted to award continued accreditation to the insurance departments of Hawaii, Kansas, Mississippi, Ohio and South Carolina.

The Committee also met in open session Nov. 3, 2011. During this meeting, the Committee:

1. Adopted immediately by reference the 2010 revision to the *Financial Condition Examiners Handbook* that was identified as significant by the Financial Examiners Handbook (E) Technical Group. This revision related to the contents and the timing of review of the examination planning memorandum. This revision had been released for a 30-day public comment period, and no comment letters were received.
2. Voted to expose for a 30-day comment period the proposed significant elements for Part A: Laws and Regulations purposes regarding the 2010 revisions to the *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450).
3. Adopted the 2008 revisions to the *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition* (#385) as additions to the Part A: Capital and Surplus standard, effective Jan. 1, 2014. These revisions provide additional standards for consideration by the commissioner to determine whether the continued operation of any insurer might be deemed to be hazardous to its policyholders, creditors or the general public. In addition, the revisions give the commissioner additional authority to issue an order requiring companies deemed to be in a hazardous financial condition to take corrective action. During the 2009 Summer National Meeting, the Committee voted to release these revisions for a one-year public comment period, which ended Dec. 31, 2010. There were no comments received, and there have been no further revisions to Model #385 since 2008.
4. Voted to expose for a 30-day comment period proposed technical revisions to the Review Team Guidelines regarding the Financial Exam Electronic Tracking System and professional designations.
5. Voted to expose for a 30-day comment period a referral from the Risk Retention Group (E) Task Force that would require the states that charter risk retention groups (RRGs) to adopt the *Risk-Based Capital for Insurers Model Act* (#312) for accreditation purposes. The Task Force noted that, although many RRGs report on an accounting basis other than statutory accounting, RBC is still an effective regulatory tool. The referral includes certain situations in which the domiciliary regulator would not be required to take action when an action level event is triggered.
6. Adopted its 2012 Proposed Charges, which remain unchanged from its 2011 Charges.

Report of the International Insurance Relations (G) Committee

The International Insurance Relations (G) Committee met Nov. 3, 2011. During the meeting, the Committee:

1. Adopted its 2012 Proposed Charges.
2. Received an update on the International Association of Insurance Supervisors (IAIS) Insurance Core Principles.
3. Received an update on the IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).
4. Received an update on the IAIS Supervisory Forum.
5. Received an update on the IAIS Financial Stability Committee and Financial Stability Board from IAIS Secretary General Yoshihiro Kawai.
6. Received an update on insurance reforms in Mexico from Gabriela Basurto, Director General, Research and Development, Department of the Insurance and Surety National Commission (CNSF-Mexico).
7. Received a report on recent meetings pursuant to the ongoing U.S.-EU Dialogue.
8. Received an update on the Joint Forum.
9. Received an update on the Organization for Economic Cooperation and Development.
10. Received a report from the Solvency Modernization Initiative (EX) Task Force.
11. Received an update on international accounting issues.
12. Received a report from the International Regulatory Cooperation (G) Working Group.
13. Received an update on international trade issues.

Drafted: 11/5/11

State Implementation Reporting of NAIC Adopted Model Laws and Regulations

Amendments to Annuity Disclosure Model Regulation (#245)—The revisions to the *Annuity Disclosure Model Regulation* (#245) were adopted by the Executive (EX) Committee/Plenary during a conference call Oct. 11. Due to the recent adoption, no states have yet taken steps to adopt the revised model. NAIC staff will begin tracking state legislative and regulatory activities in 2012. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Amendments to Suitability in Annuity Transactions Model Regulation (#275)—As of mid-September, approximately 17 states had adopted the revised model. Several more states have introduced legislation or initiated administrative rulemaking on the topic. NAIC staff will continue to track legislative and regulatory activities for this model and provide an update at the Fall National Meeting. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Model Regulation Permitting the Recognition of Preferred Mortality Tables for Use in Determining Minimum Reserve Liabilities (#815)—NAIC staff surveyed the states in October to ascertain each state's plans to adopt the model revisions. The changes to this model were adopted by the NAIC at the 2009 Fall National Meeting. The survey results indicated that 48 states have reviewed the model and compared it with their existing statute/regulation on the topic, 19 states indicated they have already adopted the model, 15 states indicated they intend to adopt the model, six indicated they intend to adopt the model with modifications, four have not yet determined if they will adopt the model, and four states indicated they did not intend to adopt the NAIC model. For additional information and updates, please contact Ryan Couch, Financial Regulatory Services Department, rcouch@naic.org.

Actuarial Opinion and Memorandum Regulation (#822)—NAIC staff surveyed the states in October to ascertain each state's plans to adopt the model revisions. The changes to this model were adopted by the NAIC at the 2009 Fall National Meeting. The survey results indicated that 48 states have reviewed the model and compared it with their existing statute/regulation on the topic, 21 states indicated they have already adopted the model, 20 states indicated they intend to adopt the model, five have not yet determined if they will adopt the model, and three indicated they did not intend to adopt the NAIC model. For additional information and updates, please contact Ryan Couch, Financial Regulatory Services Department, rcouch@naic.org.

Valuation of Life Insurance Policies Model Regulation (#830)—NAIC staff surveyed the states in October to ascertain each state's plans to adopt the model revisions. The changes to this model were adopted by the NAIC at the 2009 Fall National Meeting. The survey results indicated that 48 states have reviewed the model and compared it with their existing statute/regulation on the topic, 17 states indicated they have already adopted the model, 23 states indicated they intend to adopt the model, seven states have not yet made a determination as to if they will adopt the model, and three states indicated they did not intend to adopt the NAIC model. For additional information and updates, please contact Ryan Couch, NAIC Financial Regulatory Services Department, rcouch@naic.org.

Amendments to Health Carrier Grievance Procedure Model Act (#72) (*falls under the September 2008 federal law exemption to the Executive (EX) Committee approved requirement*)—The *Health Carrier Grievance Procedure Model Act* (#72) was revised for consistency with Section 2719 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* July 23, 2010, implementing that section. Section 2719 of the PHSA sets out requirements that health carriers must follow for the internal review of adverse benefit determinations. Section 2719 was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most of the states will be enacting legislation or revising existing regulations for consistency with the federal law. The Regulatory Framework (B) Task Force is currently considering revisions to this model to reflect the amendments made to the July 23, 2010, interim final rules, as published in the *Federal Register* June 24, 2011. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Amendments to Utilization Review and Benefit Determination Model Act (#73) (*falls under the September 2008 federal law exemption to the Executive (EX) Committee approved requirement*)—The *Utilization Review and Benefit Determination Model Act* (#73) was revised for consistency with Section 2719 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* July 23, 2010, implementing that section. Section 2719 sets out requirements that health carriers must follow for the internal review of adverse benefit determinations. Section 2719 was effective Sept. 23, 2010. NAIC staff is not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. The Regulatory Framework (B) Task Force is currently considering revisions to this model to reflect the amendments made to the July 23, 2010, interim final rules, as published in the *Federal Register* June 24, 2010. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

American Health Benefit Exchanges Model Act (#929) (*falls under the September 2008 federal law exemption to the Executive (EX) Committee approval requirement*)—As provided in Section 1311(b) of the federal Affordable Care Act (ACA), if a state elects to establish an exchange, the exchange must be established and operational no later than Jan. 1, 2014. Section 1321 of the ACA requires the secretary of the U.S. Department of Health and Human Services (HHS) to make a determination on or before Jan. 1, 2013, on whether any state that elects to establish an exchange has taken the actions the HHS secretary considers necessary to have the exchange operational by Jan. 1, 2014. This model act was developed to assist those states electing to establish an exchange. It outlines the essential duties and functions of an exchange as provided in Section 1311 of the ACA. Since its adoption in December 2010, 25 states have introduced legislation that is the same or substantially similar to the model act. Of these states, five states have enacted the legislation: Connecticut, Maryland, Oregon, Vermont and West Virginia. The legislation was vetoed in New Mexico. Nineteen states have introduced other legislation on the topic. Of these states, 11 have enacted the legislation. Also, Governors in six states have issued Executive Orders on the topic. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Model Language for Choice of Healthcare Professional (#930-A) (*falls under the September 2008 federal law exemption to Executive (EX) Committee-approval requirement*)—The model language on choice of health care professional reflects the provisions of Section 2719A of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* June 28, 2010. Section 2719A requires health insurance issuers that require or provide for designation by an enrollee of a participating primary care provider to permit each enrollee to designate any participating primary care provider who is available to accept such individual. This section and the interim final rules also impose a similar requirement for the designation of a pediatrician. Section 2719A and the interim final rules also prohibit health insurance issuers that provide coverage for obstetric and gynecological care and that require the designation of an in-network primary care provider from requiring female enrollees to obtain pre-authorization or a referral for the provision of gynecological or obstetric services from an in-network health care professional who specializes in obstetrics or gynecology. Section 2719A was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Model Language for Dependent Coverage of Individuals to Age 26 (#930-B) (*falls under the September 2008 federal law exemption to the Executive (EX) Committee approved requirement*)—The model language for dependent coverage for individuals to the age of 26 reflects the provisions of Section 2714 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* May 13, 2010, which provide that a health benefit plan or a health insurance issuer that makes available dependent coverage of children must make such coverage available for children until attainment of age 26. Section 2714 was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Model Language for Lifetime and Annual Limits (#930-C) (falls under the September 2008 federal law exemption to the Executive (EX) Committee approval requirement)—The model language for lifetime and annual limits reflects the provisions of Section 2711 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* June 28, 2010, prohibiting health insurance issuers from imposing annual or lifetime limits on the dollar amount of benefits for any individual. The interim final regulations also provide for a transition period beginning Sept. 22, 2010, until Jan. 1, 2014, for health insurance issuers to impose annual limits on essential benefits up to a specified amount. Section 2711 was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Model Language for Preventive Services (#930-D) (falls under the September 2008 federal law exemption to the Executive (EX) Committee approval requirement)—The model language for preventive services reflects the provisions of Section 2713 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* July 19, 2010, requiring health insurance issuers to provide benefits for and prohibits the imposition of cost-sharing requirements for: 1) evidence-based items and services that have in effect a rating of A or B in the current recommendations of the U.S. Preventive Services Task Force; 2) immunizations for routine use in children, adolescents and adults that have in effect a recommendation from the Advisory Committee on Immunization Practices of the U.S. Centers for Disease Control and Prevention; 3) with respect to infants, children and adolescents, evidence-informed preventive care and screenings provided for in the comprehensive guidelines supported by the Health Resources and Services Administration (HRSA); and 4) with respect to women, evidence-informed preventive care and screening provided for in comprehensive guidelines supported by HRSA. Section 2713 was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Model Language for Prohibition on Rescissions of Coverage (#930-F) (falls under the September 2008 federal law exemption to the Executive (EX) Committee approval requirement)—This model language on rescissions reflects the provisions of Section 2712 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* June 28, 2010, prohibiting health insurance issuers from rescinding coverage under a health benefit plan unless: 1) the individual performs an act, practice or omission that constitutes fraud; or 2) the individual makes an intentional misrepresentation of a material fact. The health insurance issuer must provide at least a 30-day period of advance notice of the proposed rescission before coverage is rescinded. The model language also reflects additional guidance issued by the federal agencies charged with implementing ACA. Section 2712 was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Prohibition on Preexisting Condition Exclusion for Individuals Under the Age of 19 (#930-E) (falls under the September 2008 federal law exemption to the Executive (EX) Committee approval requirement)—The model language for prohibition on preexisting condition exclusions for individuals under the age of 19 reflects the provisions of Section 2704 of the Public Health Service Act (PHSA) of the federal Affordable Care Act (ACA) and the interim final regulations published in the *Federal Register* June 28, 2010, prohibiting health insurance issuers from applying preexisting condition exclusions, including denials of coverage, to individuals under the age of 19. The model language also reflects additional guidance issued by the federal agencies charged with implementing the ACA. Section 2704 was effective Sept. 23, 2010. NAIC staff are not actively tracking state adoption because, in order for a state to have the authority to enforce this provision of federal law against health insurance issuers in the state, the state must include this provision or something substantially similar in its law or regulations. As such, it is anticipated that most states will be enacting legislation or revising existing regulations for consistency with the federal law. For additional information and updates, please contact Jolie Matthews, Sr. Health and Life Policy Counsel, jmatthews@naic.org.

Medical Professional Liability Closed Claim Reporting Model Law (#77)—This model was adopted by the Executive (EX) Committee/Plenary at the 2008 Fall National Meeting. To date, two states have adopted the model and 29 states have related activity. For additional information and updates, please contact Aaron Brandenburg, Manager I, Actuarial and Statistical Services, abranden@naic.org.

Amendments to Derivatives Instrument Model Regulation (#282)—NAIC staff surveyed the states in October 2011 to ascertain each state's plans to adopt the model revisions. The survey results indicated that 48 states have reviewed the model and compared it with their existing statute/regulation on the topic, four states indicated they have already adopted the model, 11 states indicated they intend to adopt the model, three indicated they intend to adopt the model with modifications, 17 states have not yet determined if they will adopt the model, and 13 states indicated they did not intend to adopt the NAIC model. For additional information and updates, please contact Ryan Couch, Financial Regulatory Services Department, rcouch@naic.org.

Amendments to Derivatives Risk-Based Capital (RBC) for Health Organizations Model Act (#315)—NAIC staff surveyed the states in October 2011 to ascertain each state's plans to adopt the model revisions. The survey results indicated that 45 states have reviewed the model and compared with their existing statute/regulation on the topic, eight states indicated they have already adopted the model, 23 states indicated they intend to adopt the model, six indicated they intend to adopt the model with modifications, 10 have not yet determined if they will adopt the model, and three states indicated they did not intend to adopt the NAIC model. For additional information and updates, please contact Ryan Couch, Financial Regulatory Services Department, rcouch@naic.org.

Amendments to Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385)—NAIC staff surveyed the states in October 2011 to ascertain each state's plans to adopt the model revisions. The survey results indicated that 45 states have reviewed the model and compared with their existing statute/regulation on the topic, 21 states indicated they already adopted the model, 16 states plan to adopt the revisions, four states plan to adopt the revisions with changes, four states do not plan to adopt the revisions, six states are undecided or have not yet completed their review. For additional information and updates, please contact Ryan Couch, Financial Regulatory Services Department, rcouch@naic.org.

Amendments to Insurance Holding Company System Regulatory Act (#440) and Amendments to Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (#450)—NAIC staff surveyed the states in January 2011 to gather information on plans to adopt the model revisions. The changes to this model were adopted by the NAIC membership in December 2010. Of the states that responded, five states plan to adopt the changes in 2011, 14 states plan to adopt the changes in 2012, and two states plan to adopt the changes in 2013. For additional information and updates, please contact David Vacca, Assistant Director, Insurance Analysis and Information Services, dvacca@naic.org.

Amendments to Property and Casualty Insurance Guaranty Association Model Act (#540)—Since the adoption of the revised model at the 2009 Spring National Meeting, seven states have adopted components of the revised model. Two states have proposals before the state legislature regarding aspects of the model. One state submitted a request to propose legislative changes, but was denied. Nine states are reviewing the model for a possible future legislative proposal. NAIC staff will continue to track state legislative activity and provide updates at each NAIC national meeting. For additional information and updates, please contact David Vacca, Assistant Director, Insurance Analysis and Information Services, dvacca@naic.org.