FINANCIAL CONDITION (E) COMMITTEE

Draft: 8/17/23

Financial Condition (E) Committee
Seattle, Washington
August 15, 2023

The Financial Condition (E) Committee met in Seattle, WA, Aug. 15, 2023. The following Committee members participated: Elizabeth Kelleher Dwyer, Chair (RI); Nathan Houdek, Vice Chair, and Amy Malm (WI); Mark Fowler (AL); Michael Conway (CO); Michael Yaworsky represented by Virginia Christy (FL); Amy L. Beard and Roy Eft (IN); Doug Ommen, Carrie Mears and Kevin Clark (IA); Timothy N. Schott and Vanessa Sullivan (ME); Mike Chaney represented by David Browning (MS); Chlora Lindley-Myers and John Rehagen (MO); Justin Zimmerman (NJ); Adrienne A. Harris represented by John Finston and Bob Kasinow (NY); Michael Wise (SC); Cassie Brown and Jamie Walker (TX); and Scott A. White (VA).

1. Adopted its July 19 and Spring National Meeting Minutes

The Committee met July 19 and took the following action: 1) adopted life risk-based capital (RBC) proposals 2023-09-IRE (Residuals Factor) and 2023-10-IRE (Residual Sensitivity Test Factor for Residuals); 2) adopted the *Mortgage Guaranty Insurance Model Act* (#630); and 3) adopted a new charge for a new group titled the Generator of Economic Scenarios (E/A) Subgroup of the Life Risk-Based Capital (E) Working Group.

Commissioner Houdek made a motion, seconded by Commissioner White, to adopt the Committee's July 19 (Attachment One) and March 24 minutes (*see NAIC Proceedings – Spring 2023, Financial Condition (E) Committee*). The motion passed unanimously.

2. Adopted the Reports of its Task Forces and Working Groups

Superintendent Dwyer stated that the Committee usually takes one motion to adopt its task force and working group reports that are considered technical, noncontroversial, and not significant by NAIC standards; i.e., they do not include model laws, model regulations, model guidelines, or items considered to be controversial. She reminded Committee members that after the Committee's adoption of its votes, all the technical items included within the reports adopted will be sent to the NAIC Members for review shortly after the conclusion of the Summer National Meeting as part of the Financial Condition (E) Committee Technical Changes report. Pursuant to the technical changes report process previously adopted by the Executive (EX) Committee and Plenary, the Members will have 10 days to comment. Otherwise, the technical changes will be considered adopted by the NAIC and effective immediately. With respect to the task force and working group reports, Superintendent Dwyer asked the Committee: 1) whether there were any items that should be discussed further before being considered for adoption and sent to the Members for consideration as part of the technical changes; and 2) whether there were other issues not up for adoption that are currently being considered by task forces or workings groups reporting to this Committee that require further discussion. The response to both questions was no.

In addition to presenting the reports for adoption, Superintendent Dwyer noted that the Financial Analysis (E) Working Group met Aug. 12, July 20, June 14 and 21, May 24, and May 25 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities, or individuals) of the NAIC Policy Statement on Open Meetings, to discuss letter responses and financial results. Additionally, the Valuation Analysis (E) Working Group met Aug 12, July 20, and May 18 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities, or individuals) of the NAIC Policy Statement on Open Meetings, to discuss valuation items related to specific companies. Finally, the National Treatment and Coordination (E) Working Group met in regulator-to-regulator session Aug. 2, July 26, and June 15, pursuant to paragraph 6 (consultations with NAIC staff members related to NAIC technical guidance), to continue work on its goals.

Walker made a motion, seconded by Acting Superintendent Schott, to adopt the following task force and working group reports: Accounting Practices and Procedures (E) Task Force; Capital Adequacy (E) Task Force; Examination Oversight (E) Task Force; Financial Stability (E) Task Force; Receivership and Insolvency (E) Task Force; Reinsurance (E) Task Force; Valuation of Securities (E) Task Force; Group Capital Calculation (E) Working Group (Attachment Two); Mortgage Guaranty Insurance (E) Working Group (Attachment Three); Restructuring Mechanisms (E) Working Group (Attachment Four); and Risk-Focused Surveillance (E) Working Group (Attachment Five). The motion passed unanimously.

3. Adopted the Macroprudential Reinsurance Worksheet

Kasinow summarized the work by the Macroprudential (E) Working Group leading up to its adoption of the reinsurance worksheet in June. He emphasized that the worksheet was designed for regulators to assess cross-border reinsurance treaties where there are different regulatory systems involved and is intended to assist in identifying if there are true economic impacts from the reinsurance transaction. He noted that it is not intended to be used for every reinsurance contract and that it should be used in a way to avoid duplicating requested information. It is geared toward life insurance contracts. However, there is no reason to limit the tool to life; it can be used on property/casualty (P/C) reinsurance contracts. The worksheet is an optional tool and will not be included in the *Financial Analysis Handbook*, but it is available on StateNet to be used when deemed appropriate.

Rehagen made a motion, seconded by Commissioner Ommen, to adopt the macroprudential reinsurance worksheet (Attachment Six). The motion passed unanimously.

4. Adopted INT 23-01: Net Negative (Disallowed) IMR

Dale Bruggeman (OH), Chair of the Statutory Accounting Principles (E) Working Group, summarized Interpretation (INT) 23-01: Net Negative (Disallowed) IMR. Bruggeman started with a timeline of the work. He noted that the Working Group exposed the idea of an initial project as a short-term Interpretation at the 2022 Fall National Meeting, and it heard comments at the 2023 Spring National Meeting. At that meeting, the Working Group gave NAIC staff directions for a proposed interpretation to be exposed. The Working Group heard comments on that exposure at a meeting in June and re-exposed a revised interpretation at that time. On Aug. 13, the Working Group adopted INT 23-01. Bruggeman noted the adopted interpretation is effective immediately and through year-end 2025, which gives industry, regulators, and others a few years to develop a long-term approach. The adopted INT reflects the following:

- The requirement for RBC to be over 300% authorized control level (ACL) RBC after adjustment to remove admitted positive goodwill, EDP equipment and operating system software, deferred tax assets (DTAs), and admitted negative interest maintenance reserve (IMR) (referred to as softer assets).
- Allowance to admit up to 10% of adjusted capital and surplus (excluding those softer assets), first in the general account, and then if all disallowed IMR in the general account is admitted and the percentage limit is not reached, then to the separate account proportionately between insulated and non-insulated accounts—those that have assets at book value. (The adjustments are the same that occur for the RBC adjustment and reduce capital and surplus before applying the 10% percentage limit.)
- Application guidance for admitting/recognizing IMR in both the general and separate accounts, including a specific name to use in each. Also, reporting entities shall allocate an amount equal to the general account admitted net negative (disallowed) IMR from unassigned funds to an aggregate write-in for special surplus funds (line 34) (named as “Admitted Disallowed IMR”). Although dividends are contingent on state-specific statutes and laws, the intent of this reporting is to provide transparency and preclude the ability for admitted negative IMR to be reported as funds available to dividend.

- No exclusion for derivatives losses included in negative IMR if the reporting entity can demonstrate historical practice in which realized gains from derivatives were also reversed to IMR (as liabilities) and amortized.
- Inclusion of a new reporting entity attestation, which continues the existing practice that losses cannot be deferred as a result of a forced sale due to liquidity issues, along with commentary that assets were sold as part of prudent asset management, following documented investment or liability management policies.

Bruggeman said that it was important to note that this interpretation does not place key reliance on asset adequacy testing (AAT) as requested by the Life Actuarial (A) Task Force. AAT performed by actuaries will still use the IMR as a natural liability or as an admitted asset. He said it is important to note that the larger the admitted asset within AAT, the greater the chance of having an additional AAT reserve requirement. Bruggeman also noted that the Working Group started the longer-term project through exposure of agenda item 2023-14. The Working Group also exposed some blanks instructional provisions for when interest related realized gains/losses go through IMR (that is deferred from the income statement) and when the result goes through the asset valuation reserve (AVR) calculation and thus through the income statement. There were some holes in how the instructions read. The Working Group intends to use an ad hoc technical group, and with any required approvals from the parent groups, to nail down the issues and get any needed help from the Life Actuarial (A) Task Force and/or the American Academy of Actuaries (Academy).

Commissioner Houdek made a motion, seconded by Acting Superintendent Schott, to adopt INT 23-01 (Attachment Seven). The motion passed with New York abstaining.

5. Heard a Presentation from the OFSI on the Use of AI

Jacqueline Friedland (Office of the Superintendent of Financial Institutions—OFSI) provided an overview of some of the work that OFSI had conducted relative to data analytics, including its use of artificial intelligence (AI) (Attachment Eight). Friedland emphasized a number of areas during her presentation, including that her presentation and her approach to things were influenced by her background as an actuary, where data is a powerful source of information that can enhance efficiency and effectiveness. She discussed Canada's financial condition testing (FCT) report that is required annually of insurers and how it is the single most important report used for prudential regulation in Canada. She described her past experience, starting with Canada and the expectations she set out for her staff in using the reports, and how using natural language generation AI can increase efficiencies and effectiveness in such reviews by her staff.

Friedland also discussed her work and that of her staff in retooling the reports for their use with International Financial Reporting Standard (IFRS) 17 *Insurance Contracts*. Her greatest emphasis was placed on the next topic, the Risk Assessment Data Analytics Report (RADAR), which is an interactive dashboard of common financial risk indicators across insurance and banking. At its core, the report pulls in various data elements and color codes the area of data to indicate, based upon industry data, whether the area being reviewed by the regulator is an area of concern or where follow-up is needed. The system uses a comprehensive and interactive training program that was developed using various inputs, including the NAIC's Insurance Regulatory Information System (IRIS) ratios manual.

Additionally, Friedland discussed OFSI's use of the Meltwater media monitoring tool, which allows insurance supervisors to monitor media and social media across companies, industries, and topics. It is particularly helpful for parent company monitoring. Finally, Friedland discussed the use of natural language processing (NLP) for reinsurance. OFSI is seeking more details about the use of reinsurance across the industry, in terms of attachment points, participation, limits, etc. NLP allows OFSI to extract unstructured data that lacks consistency from actuarial reports to where it is more usable.

6. Exposed the *Framework for Regulation of Insurer Investments*

Superintendent Dwyer reminded meeting participants that included with the materials for the meeting was a draft *Framework for Regulation of Insurer Investments*. She explained that the purposes of this document are to: 1) provide a holistic overview of what various working groups and task forces are doing in this area; and 2) state that this work is under the purview of the commissioners and other regulators making up the Committee. Superintendent Dwyer said she intends to hear from all interested parties as the Committee finalizes this document, but the Committee does not plan to stop any of the work that is currently underway related to this project. The three main pieces of that work that are underway are: 1) work at the Risk-Based Capital Investment Risk and Evaluation (E) Working Group to modify the life RBC formula; 2) work at the Valuation of Securities (E) Task Force that authorized the Structured Securities Group (SSG) to begin financially modeling collateralized loan obligations (CLOs) beginning December 2024; and 3) work at the Valuation of Securities (E) Task Force that proposes to establish processes and procedures by which the Securities Valuation Office (SVO) would be authorized to challenge the credit rating for a filing exempt (FE) security. Superintendent Dwyer noted that during this meeting, she wanted to hear comments from regulators.

Rehagen noted that the document is good, especially the enhancements and the different regulatory initiatives regulators are undertaking because they need this type of ability with the increasing complexity of investments—specifically, having services that assist regulators in determining how risky a security it is. Superintendent Dwyer noted that it was drafted by a small ad hoc group of committee members and that having everyone’s input on it will be helpful.

Mears noted the document would have a major impact on the Valuation of Securities (E) Task Force. She said that speaking for Iowa, she supports the framework and wanted to reiterate that none of the existing work will be pausing. Mears said the Valuation of Securities (E) Task Force, which she chairs, will continue its deliberative process, and take into account all the feedback received from interested parties, but the Task Force will still be moving forward in that direction. Mears noted that the framework, if supported, provides a future vision of what centralized investment expertise is available to U.S. regulators. She said that it is understandable that many of these initiatives will be costly and will take some time as issues arise. She said that whether it is with the Valuation of Securities (E) Task Force or the Risk-Based Capital Investment Risk and Evaluation (E) Working Group, the framework looks beyond the different economic cycles or stresses that could be in place and allows regulators to be thoughtful and deliberative. Mears said this is an opportune time for the document given the work ahead.

Commissioner Beard thanked Superintendent Dwyer for her leadership on this document. She noted the Committee took a measured approach and was able to expedite this important issue in discussions. Commissioner Beard stated appreciation for the non-prescriptive approach that the framework will allow the regulators to take. She said it gives peace of mind knowing that the Committee participates in the process and that the Committee will be able to rely on the subject matter experts (SMEs) for their expertise.

Commissioner White made a motion, seconded by Commissioner Houdek, to expose the framework draft for a 45-day public comment period ending Oct. 2. The motion passed unanimously.

Having no further business, the Financial Condition (E) Committee adjourned.

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Draft: 7/24/23

Financial Condition (E) Committee
Virtual Meeting
July 19, 2023

The Financial Condition (E) Committee met July 19, 2023. The following Committee members participated: Elizabeth Kelleher Dwyer, Chair (RI); Nathan Houdek, Vice Chair (WI); Mark Fowler (AL); Michael Conway represented by Rolf Kaumann (CO); Michael Yaworsky represented by Chris Struk (FL); Doug Ommen (IA); Amy L. Beard represented by Roy Eft (IN); Timothy N. Schott (ME); Chlora Lindley-Myers represented by John Rehagen (MO); Mike Chaney represented by Chad Bridges (MS); Justin Zimmerman represented by David Wolf (NJ); Adrienne A. Harris represented by John Finston and Bob Kasinow (NY); Michael Wise (SC); Cassie Brown represented by Jamie Walker (TX); and Scott A. White represented by Doug Stolte (VA). Also participating were: Philip Barlow (DC); Jackie Obusek (NC); and Tom Botsko (OH).

1. Adopted Life RBC Proposals 2023-09-IRE (Residuals Factor) and 2023-10-IRE (Residual Sensitivity Test Factor for Residuals)

Superintendent Dwyer stated that this item related to the topic of residual interest investments, which the Committee began discussing a couple of years ago and in early 2022, asked the newly formed Risk-Based Capital (RBC) Investment Risk and Evaluation (E) Working Group to address. Barlow described how the Working Group had been working on this issue since early 2022 and on into the first half of the year until it was recently adopted. He described that earlier in the year, the Working Group adopted the structure in the Life RBC formula that created a new reporting line for residual investments within the formula. He stated that the Working Group also adopted a structure earlier this year for a sensitivity test related to the residual tranches. Factors for both of these structures were not adopted until more recently, which went through a lot of discussion at the Working Group level before ultimately being adopted. Barlow noted that the two proposals before the Committee collectively represent a proposal submitted by the Texas Department of Insurance (DOI), and that was unanimously adopted by the Working Group. He discussed the features of the proposal, including a factor for residual investments starting at 30% for 2023 and 45% for 2024 and going forward but leaving space for a proposal to be submitted that supports either a higher or lower factor for 2024 if deemed more acceptable based upon data provided by the sponsor of the proposal. The sensitivity test for the residual investments for 2023 is set at 15%, and 0% for 2024 since the factor already reflects the full 45%. Botsko commended Barlow for the great work done on this project and to all of the Working Group members that provided the Capital Adequacy (E) Task Force with the proposal that was unanimously adopted at that level.

Walker made a motion, seconded by Stolte, to adopt proposals 2023-09-IRE and 2023-10-IRE (Attachment One-A). The motion passed unanimously.

2. Adopted a New Charge and a New Group Titled the Generator of Economic Scenarios (E/A) Subgroup of the Life Risk-Based Capital (E) Working Group

Barlow described that this was an issue the Life Risk-Based Capital (E) Working Group had been working on with the Life Actuarial (A) Task Force for some time, and it involves replacing the current generator of economic scenarios (GOES) that is used for both reserves and capital. He stated that he would not go into all the details; this is being done, but the work is proceeding with substantial progress, and new charges are being requested to establish some governance and related structure around the GOEA once it is developed. He noted that this was adopted by the Life Insurance and Annuities (A) Committee. He stated that Iowa has agreed to chair the Subgroup, and Ohio has agreed to vice chair the Subgroup. He also stated that while a good membership has already volunteered, anyone interested can contact NAIC staff or himself.

Finston made a motion, seconded by Kaumann, to form the new subgroup named the Generator of Economic Scenarios (E/A) Subgroup of the Life Risk-Based Capital (E) Working Group with the proposed charges as presented (Attachment One-B). The motion passed unanimously.

3. Adopted Model #630

Obusek stated that the Mortgage Guaranty Insurance (E) Working Group was charged with updating the *Mortgage Guaranty Insurance Model Act* (#630) to strengthen and modernize the model in response to the 2008 financial crisis. The last time the model was substantially updated was 1976. Obusek noted that the Executive (EX) Committee approved the Request for NAIC Model Law Development in July 2013. At that time, the development of a capital model to accompany Model #630 was the key focus of the Financial Condition (E) Committee's attention. The Working Group worked with two different consulting firms over several years to attempt to build a capital model, which was met with several challenges. In April 2021, the Working Group referred a draft mortgage guaranty exhibit to the Blanks (E) Working Group, and the exhibit was finalized and integrated into the blank, effective year-end 2021. In May 2022, the Mortgage Guaranty Insurance (E) Working Group decided to pause the development of the capital model and continue collecting data for further analysis in the future. As a result, the Working Group focused on finalizing the amendments to Model #630. Obusek noted that the Model #630 Drafting Group consisted of all of the members of the Working Group represented by herself as the chair; Kurt Regner (AZ); Monica Macaluso and Joyce Zeng (CA); Robert Ballard (FL); Rehagen (MO); Margot Small (NY); Diana Sherman (PA); Amy Garcia (TX); and Amy Malm and Levi Olson (WI). Obusek stated that over the next 14 months, the drafting group met 12 times, and Model #630 was exposed for public comment on Oct. 7, 2022; Feb. 27, 2023; and May 11, 2023. During those exposures, various comments were received from the mortgage guaranty consortium and the consumer representatives and discussed both by the drafting group and during open meetings of the Working Group. She noted that many of the comments received were addressed through changes integrated into the draft model included in the proposed changes. Some of the more significant amendments dealt with the reserving requirements related to contingency reserves and waivers with respect to risk in-force. The Working Group adopted the amended Model #630 during its July 13 conference call. Superintendent Dwyer reminded the Committee that in order to advance Model #630 to the Executive (EX) Committee and Plenary for consideration, a two-thirds majority vote is needed by the Financial Condition (E) Committee members in total; therefore 10 members would need to vote yes.

Commissioner Houdek made a motion, seconded by Rehagen, to adopt Model #630 (Attachment One-C). The motion passed unanimously.

Having no further business, the Financial Condition (E) Committee adjourned.

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Capital Adequacy (E) Task Force

RBC Proposal Form

☐ Capital Adequacy (E) Task Force
☐ Catastrophe Risk (E) Subgroup
☐ Variable Annuities Capital. & Reserve (E/A) Subgroup
☐ Health RBC (E) Working Group
☐ P/C RBC (E) Working Group
☐ Economic Scenarios (E/A) Subgroup
☐ Life RBC (E) Working Group
☐ Longevity Risk (A/E) Subgroup
☒ RBC Investment Risk & Evaluation (E) Working Group

		FOR NAIC USE ONLY
	DATE: 4/20/23	Agenda Item # 2023-09-IRE Year 2023
CONTACT PERSON:	Dave Fleming	**DISPOSITION**
TELEPHONE:	816-783-8121	**ADOPTED:** ☒ TASK FORCE (TF) 6/30 ☒ WORKING GROUP (WG) 6/14 ☐ SUBGROUP (SG)
EMAIL ADDRESS:	dfleming@naic.org	**EXPOSED:** ☐ TASK FORCE (TF) ☒ WORKING GROUP (WG) ☐ SUBGROUP (SG)
ON BEHALF OF:	RBC Inv. Risk & Eval. (E) Working Group	**REJECTED:** ☐ TF ☐ WG ☐ SG
NAME:	Philip Barlow	**OTHER:** ☐ DEFERRED TO ☐ REFERRED TO OTHER NAIC GROUP ☐ (SPECIFY)
TITLE:	Associate Commissioner for Insurance	
AFFILIATION:	District of Columbia	
ADDRESS:	1050 First Street, NE Suite 801 Washington, DC 20002	

IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

☐ Health RBC Blanks ☐ Property/Casualty RBC Blanks ☒ Life and Fraternal RBC Blanks
☐ Health RBC Instructions ☐ Property/Casualty RBC Instructions ☐ Life and Fraternal RBC Instructions
☐ Health RBC Formula ☐ Property/Casualty RBC Formula ☐ Life and Fraternal RBC Formula
☐ OTHER ______

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal applies a .45 base RBC factor in the life RBC formula for residual tranches.

Additional Staff Comments:

DF – The Working Group adopted a factor of .30 for yearend 2023 to be replaced by .45 beginning with yearend 2024 with consideration of positive or negative adjustment based on additional information.
EY- The Task Force adopted this proposal and 2023-10-IRE together during June 30 meeting.

** **This section must be completed on all forms.** **Revised 2-2023**

OTHER LONG-TERM ASSETS (CONTINUED)

		Annual Statement Source	(1) Book / Adjusted Carrying Value	(2) Unrated Items ‡	(3) RBC Subtotal †		(4) Factor		(5) RBC Requirement
	Schedule BA - Unaffiliated Common Stock								
(42)	Schedule BA Unaffiliated Common Stock-Public	AVR Equity Component Column 1 Line 65				X	§	=	
(43)	Schedule BA Unaffiliated Common Stock-Private	AVR Equity Component Column 1 Line 66				X	0.3000	=	
(44)	Total Schedule BA Unaffiliated Common Stock (pre-MODCO/Funds Withheld)	Line (42) + (43)							
(45)	Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)							
(46)	Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)							
(47)	Total Schedule BA Unaffiliated Common Stock (including MODCO/Funds Withheld.)	Lines (44) - (45) + (46)							
	Schedule BA - All Other								
(48.1)	BA Affiliated Common Stock - Life with AVR	AVR Equity Component Column 1 Line 67							
(48.2)	BA Affiliated Common Stock - Certain Other	AVR Equity Component Column 1 Line 68							
(48.3)	Total Schedule BA Affiliated Common Stock - C-1o	Line (48.1) + (48.2)				X	0.3000	=	
(49.1)	BA Affiliated Common Stock - All Other	AVR Equity Component Column 1 Line 69							
(49.2)	Total Sch. BA Affiliated Common Stock - C-1cs	Line (49.1) ~~+ AVR Equity Component Column 1 Line 93~~				X	0.3000	=	
(50)	Schedule BA Collateral Loans	Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999				X	0.0680	=	
(51)	**Total Residual Tranches or Insterests**	**AVR Equity Component Column 1 Line 93**				**X**	**0.3000**	**=**	
(52.1)	NAIC 01 Working Capital Finance Notes	AVR Equity Component Column 1 Line 94				X	0.0050	=	
(52.2)	NAIC 02 Working Capital Finance Notes	AVR Equity Component Column 1 Line 95				X	0.0163	=	
(52.3)	Total Admitted Working Capital Finance Notes	**Line (52.1) + (52.2)**							
(53.1)	Other Schedule BA Assets	AVR Equity Component Column 1 Line 96							
(53.2)	Less NAIC 2 thru 6 Rated/Designated Surplus Notes and Capital Notes	Column (1) Lines (23) through (27) + Column (1) Lines (33) through (37)							
(53.3)	Net Other Schedule BA Assets	**Line (53.1) less (53.2)**				X	0.3000	=	
(54)	Total Schedule BA Assets C-1o (pre-MODCO/Funds Withheld)	Lines (11) + (21) + (31) + (41) + (48.3) + (50)+ **(52.3) + (53.3)**							
(55)	Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)							
(56)	Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)							
(57)	Total Schedule BA Assets C-1o (including MODCO/Funds Withheld.)	Lines **(54) - (55) + (56)**							
(58)	Total Schedule BA Assets Excluding Mortgages and Real Estate	Line (47) + (49.2) **+ (51) + (57)**							

† Fixed income instruments and surplus notes designated by the NAIC Capital Markets and Investment Analysis Office or considered exempt from filing as specified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* should be reported in Column (3).

‡ Column (2) is calculated as Column (1) less Column (3) for Lines (1) through (17). Column (2) equals Column (3) - Column (1) for Line **(53.3)**.

§ The factor for Schedule BA publicly traded common stock should equal 30 percent adjusted up or down by the weighted average beta for the Schedule BA publicly traded common stock portfolio subject to a minimum of 22.5 percent and a maximum of 45 percent in the same manner that the similar 15.8 percent factor for Schedule BA publicly traded common stock in the Asset Valuation Reserve (AVR) calculation is adjusted up or down. The rules for calculating the beta adjustment are set forth in the AVR section of the annual statement instructions.

Denotes items that must be manually entered on the filing software.

Capital Adequacy (E) Task Force

RBC Proposal Form

☐ Capital Adequacy (E) Task Force ☐ Health RBC (E) Working Group ☐ Life RBC (E) Working Group
☐ Catastrophe Risk (E) Subgroup ☐ P/C RBC (E) Working Group ☐ Longevity Risk (A/E) Subgroup
☐ Variable Annuities Capital. & Reserve (E/A) Subgroup ☐ Economic Scenarios (E/A) Subgroup ☒ RBC Investment Risk & Evaluation (E) Working Group

		FOR NAIC USE ONLY
	DATE: 4/20/23	Agenda Item # 2023-10-IRE Year 2023
CONTACT PERSON:	Steve Clayburn	**DISPOSITION**
TELEPHONE:	(202)624-2197	**ADOPTED:** ☒ TASK FORCE (TF) 6/30 ☒ WORKING GROUP (WG) 6/14 ☐ SUBGROUP (SG)
EMAIL ADDRESS:	steveclayburn@acli.com	**EXPOSED:** ☐ TASK FORCE (TF) ☒ WORKING GROUP (WG) ☐ SUBGROUP (SG)
ON BEHALF OF:	American Council of Life Insurers (ACLI)	**REJECTED:** ☐ TF ☐ WG ☐ SG
NAME:	Steve Clayburn	**OTHER:** ☐ DEFERRED TO ☐ REFERRED TO OTHER NAIC GROUP ☐ (SPECIFY)
TITLE:		
AFFILIATION:		
ADDRESS:		

IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

☐ Health RBC Blanks ☐ Property/Casualty RBC Blanks ☒ Life and Fraternal RBC Blanks
☐ Health RBC Instructions ☐ Property/Casualty RBC Instructions ☐ Life and Fraternal RBC Instructions
☐ Health RBC Formula ☐ Property/Casualty RBC Formula ☐ Life and Fraternal RBC Formula
☐ OTHER ____________

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

The adoption by the Working Group of proposal 2023-04-IRE provides the structure for this sensitivity test. This proposal is to address the factor to be applied in that test.

Additional Staff Comments:

DF – The Working Group adopted a factor of .15 for yearend 2023.
EY- The Task Force adopted this proposal and 2023-09-IRE together during June 30 meeting.

** **This section must be completed on all forms.** **Revised 2-2023**

SENSITIVITY TESTS - AUTHORIZED CONTROL LEVEL

	Sensitivity Tests Affecting Authorized Control Level Risk-Based Capital	Source	(1) Statement Value	Additional Sensitivity Factor	(2) Additional RBC	(3) Authorized Control Level Before Test	(4) Authorized Control Level After Test
(1.1)	Other Affiliates: Company	LR042 Summary for Affiliated Investments Column (1) Line (13)		0.700			
(1.2)	Other Affiliates: Subsidiaries	LR038 Additional Information Required Column (1) Line (1.2)		0.700			
(1.99)	Total Other Affiliates			0.700			
(2.1)	Noncontrolled Assets - Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (15)		0.020			
(2.2)	Noncontrolled Assets - Subsidiaries	LR038 Additional Information Required Column (1) Line (2.2)		0.020			
(2.99)	Total Noncontrolled Assets			0.020			
(3.1)	Guarantees for Affiliates: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (24)		0.020			
(3.2)	Guarantees for Affiliates: Subsidiaries	LR038 Additional Information Required Column (1) Line (3.2)		0.020			
(3.99)	Total Guarantees for Affiliates			0.020			
(4.1)	Contingent Liabilities: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (25)		0.020			
(4.2)	Contingent Liabilities: Subsidiaries	LR038 Additional Information Required Column (1) Line (4.2)		0.020			
(4.99)	Total Contingent Liabilities			0.020			
(5.1)	Long-Term Leases: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (26)		0.030			
(5.2)	Long-Term Leases: Subsidiaries	LR038 Additional Information Required Column (1) Line (5.2)		0.030			
(5.99)	Total Long-Term Leases			0.030			
(7.1)	Affiliated Investments†: Company	LR038 Additional Information Required Column (1) Line (7.14)		0.100			
(7.2)	Affiliated Investments†: Subsidiaries	LR038 Additional Information Required Column (1) Line (7.2)		0.100			
(7.99)	Total Affiliated Investments			0.100			
(8.1)	**Total Residual Tranches or Interests**	**LR038 Additional Information Required Column (1) Line (11.1)**		**0.150**			

† Excluding affiliated preferred and common stock

Denotes items that must be manually entered on the filing software.

1. The **Generator of Economic Scenarios (GOES) (E/A) Subgroup** of the Life Risk-Based Capital (E) Working Group and the Life Actuarial (A) Task Force will:
   A. Monitor that the economic scenario governance framework is being appropriately followed by all relevant stakeholders involved in scenario delivery.
   B. Review material economic scenario generator updates, either driven by periodic model maintenance or changes to the economic environment and provide recommendations.
   C. Regularly review key economic conditions and metrics to evaluate the need for off-cycle or significant economic scenario generator updates and maintain a public timeline for economic scenario generator updates.
   D. Support the implementation of an economic scenario generator for use in statutory reserve and capital calculations.
   E. Develop and maintain acceptance criteria that reflect history as well as plausibly more extreme scenarios.

Draft: [May 11, 2023]
Adopted by Mortgage Guaranty Insurance (E) Working Group—[July 13, 2023]
Adopted by [insert parent committee]—[insert date]

MORTGAGE GUARANTY INSURANCE MODEL ACT

Table of Contents

Section 1. Title

This Act may be cited as the Mortgage Guaranty Insurance Act.

Section 2. Definitions

The definitions set forth in this Act shall govern the construction of the terms used in this Act but shall not affect any other provisions of the code.

A. "Authorized Real Estate Security" means:

(1) An amortized note, bond or other instrument of indebtedness, except for reverse mortgage loans made pursuant to [insert citation of state law that authorizes reverse mortgages] of the real property law, evidencing a loan, not exceeding one hundred three percent (103%) of the fair market value of the real estate, secured by a mortgage, deed of trust, or other instrument that constitutes, or is equivalent to, a first lien or junior lien or charge on real estate, with any percentage in excess of one hundred percent (100%) being used to finance the fees and closing costs on such indebtedness; provided:

(a) The real estate loan secured in this manner is one of a type that a creditor, which is supervised and regulated by a department of any state or territory of the U.S or an agency of the federal government, is authorized to make, or would be authorized to make, disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate;

(b) The loan is to finance the acquisition, initial construction or refinancing of real estate that is a:

(i) Residential building designed for occupancy by not more than four families, a one-family residential condominium or unit in a planned unit development, or any other one-family residential unit as to which title may be conveyed freely; or

(ii) Mixed-use building with only one non-residential use and one one-family dwelling unit; or

(iii) Building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes.

(c) The lien on the real estate may be subject to and subordinate to other liens, leases, rights, restrictions, easements, covenants, conditions or regulations of use that do not impair the use of the real estate for its intended purpose.

(2) Notwithstanding the foregoing, a loan referenced in Section 2A(1) of this Act may exceed 103% of the fair market value of the real estate in the event that the mortgage guaranty insurance company has approved for loss mitigation purposes a request to refinance a loan that constitutes an existing risk in force for the company.

(3) An amortized note, bond or other instrument of indebtedness evidencing a loan secured by an ownership interest in, and a proprietary lease from, a corporation or partnership formed for the purpose of the cooperative ownership of real estate and at the time the loan does not exceed one hundred three percent (103%) of the fair market value of the ownership interest and proprietary lease, if the loan is one of a type that meets the requirements of Section 2A(1)(a), unless the context clearly requires otherwise, any reference to a mortgagor shall include an owner of such an ownership interest as described in this paragraph and any reference to a lien or mortgage shall include the security interest held by a lender in such an ownership interest.

B. "Bulk Mortgage Guaranty Insurance" means mortgage guaranty insurance that provides coverage under a single transaction on each mortgage loan included in a defined portfolio of loans that have already been originated.

C. "Certificate of Insurance" means a document issued by a mortgage guaranty insurance company to the initial insured to evidence that it has insured a particular authorized real estate security under a master policy, identifying the terms, conditions and representations, in addition to those contained in the master policy and endorsements, applicable to such coverage.

D. "Commissioner." The term "commissioner" shall mean the insurance commissioner, the commissioner's deputies, or the Insurance Department, as appropriate.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the word "commissioner" appears.

E. "Contingency Reserve" means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.

F. "Domiciliary Commissioner" means the principal insurance supervisory official of the jurisdiction in which a mortgage guaranty insurance company is domiciled.

G. "Effective Guaranty" refers to the assumed backing of existing or future holders of securities by virtue of their issuer's conservatorship or perceived access to credit from the U.S. Treasury, as opposed to the direct full faith and credit guarantee provided by the U.S. government.

H. "Loss" refers to losses and loss adjustment expenses.

I. "Master Policy" means a document issued by a mortgage guaranty insurance company that establishes the terms and conditions of mortgage guaranty insurance coverage provided thereunder, including any endorsements thereto.

J. "Mortgage Guaranty Insurance" is insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any authorized real estate security.

K. "Mortgage Guaranty Quality Assurance Program" means an early detection warning system for potential underwriting compliance issues which could potentially impact solvency or operational risk within a mortgage guaranty insurance company.

L. "NAIC" means the National Association of Insurance Commissioners.

M. "Pool Mortgage Guaranty Insurance" means mortgage guaranty insurance that provides coverage under a single transaction or a defined series of transactions on a defined portfolio of loans for losses up to an aggregate limit.

N. "Right of Rescission" represents a remedy available to a mortgage guaranty insurance company to void a certificate and restore parties to their original position, based on inaccurate, incomplete or misleading information provided to, or information omitted or concealed from, the mortgage guaranty insurance company in connection with the insurance application, resulting in an insured loan that did not meet the mortgage guaranty insurance company's eligibility requirements in effect on the date of submission of the insurance application.

O. "Risk in Force" means the mortgage guaranty insurance coverage percentage applied to the unpaid principal balance.

Section 3. Insurer's Authority to Transact Business

A company may not transact the business of mortgage guaranty insurance until it has obtained a certificate of authority from the commissioner.

Section 4. Mortgage Guaranty Insurance as Monoline

A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.

Section 5. Risk Concentration

A mortgage guaranty insurance company shall not expose itself to any loss on any one authorized real estate security risk in an amount exceeding ten percent (10%) of its surplus to policyholders. Any risk or portion of risk which has been reinsured shall be deducted in determining the limitation of risk.

Section 6. Capital and Surplus

A. **Initial and Minimum Capital and Surplus Requirements.** A mortgage guaranty insurance company shall not transact the business of mortgage guaranty insurance unless, if a stock insurance company, it has paid-in capital of at least $10,000,000 and paid-in surplus of at least $15,000,000, or if a mutual insurance company, a minimum initial surplus of $25,000,000. A stock insurance company or a mutual insurance company shall at all times thereafter maintain a minimum policyholders' surplus of at least $20,000,000.

B. **Minimum Capital Requirements Applicability.** A mortgage guaranty insurance company formed prior to the passage of this Act may maintain the amount of capital and surplus or minimum policyholders' surplus previously required by statute or administrative order for a period not to exceed twelve months following the effective date of the adoption of this Act.

C. **Minimum Capital Requirements Adjustments.** The domiciliary commissioner may by order reduce the minimum amount of capital and surplus or minimum policyholders' surplus required under Section 6A under the following circumstances:

(1) For an affiliated reinsurer that is a mortgage guaranty insurance company and that is or will be engaged solely in the assumption of risks from affiliated mortgage guaranty insurance companies, provided that the affiliated reinsurer is in run-off and, in the domiciliary commissioner's opinion,

the business plan and other relevant circumstances of the affiliated reinsurer justify the proposed reduction in requirements.

(2) For mortgage guaranty insurance companies that are in run-off and not writing new business that is justified in a business plan, in the domiciliary commissioner's opinion.

Section 7. Geographic Concentration

A. A mortgage guaranty insurance company shall not insure loans secured by a single risk in excess of ten percent (10%) of the company's aggregate capital, surplus and contingency reserve.

B. No mortgage guaranty insurance company shall have more than twenty percent (20%) of its total insurance in force in any one Standard Metropolitan Statistical Area (SMSA), as defined by the U.S Department of Commerce.

C. The provisions of this section shall not apply to a mortgage guaranty insurance company until it has possessed a certificate of authority in this state for three (3) years.

Section 8. Advertising

No mortgage guaranty insurance company or an agent or representative of a mortgage guaranty insurance company shall prepare or distribute or assist in preparing or distributing any advertising media or communication to the effect that the real estate investments of any financial institution are "insured investments," unless the advertising media or communication clearly states that the loans are insured by mortgage guaranty insurance companies possessing a certificate of authority to transact mortgage guaranty insurance in this state or are insured by an agency of the federal government.

Section 9. Investment Limitation

Investments in notes or other evidence of indebtedness secured by a mortgage or other liens upon residential real property shall not be allowed as assets in any determination of the financial condition of a mortgage guaranty insurer. This section shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contract of sale are acquired in the course of good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property so acquired. This section shall not apply to investments backed by the full faith and credit of the U.S. Government or investments with the effective guaranty of the U.S. Government. This section shall not apply to investments held by a mortgage guaranty insurance company prior to the passage of this Act.

Section 10. Reserve Requirements

A. **Unearned premium Reserves, Loss Reserves, and Premium Deficiency Reserves.** Financial reporting will be prepared in accordance with the Accounting Practices and Procedures Manual and Annual Financial Statement Instructions of the NAIC.

B. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:

(1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.

(2) Except as provided within this Act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, to provide for reserve buildup. The portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.

(3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis or such other basis, with the prior written approval of the domiciliary commissioner, based on the amount by which:

(a) Incurred losses and loss adjustment expenses exceed 35% of the direct earned premium in any year. Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal as adjusted for the quarterly nature of the withdrawal; or

(b) Upon the approval of the domiciliary commissioner and 30-day prior notification to non-domiciliary commissioners, a mortgage guaranty insurer may withdraw from the contingency reserve any amounts which are in excess of the requirements of Section 15 as required in [insert section of the mortgage guaranty Insurance model law requiring minimum policyholder's position] as filed with the most recently filed annual statement.

(i) The mortgage guaranty insurance company's domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.

C. **Miscellaneous.** Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.

Section 11. Reinsurance

A. **Prohibition of Captive Reinsurance.** A mortgage guaranty insurance company shall not enter into captive reinsurance arrangements which involve the direct or indirect ceding of any portion of its insurance risks or obligations to a reinsurer owned or controlled by an insured; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity owned or controlled by an insured or an insured's officer, director or employee or any member of their immediate family that has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

B. **Reinsurance Cessions.** A mortgage guaranty insurer may, by written contract, reinsure any insurance that it transacts, except that no mortgage guaranty insurer may enter into reinsurance arrangements designed to circumvent the compensating control provisions of Section 17 or the contingency reserve requirement of Section 10. The unearned premium reserve and the loss reserves required by Section 10 shall be established and maintained by the direct insurer or by the assuming reinsurer so that the aggregate reserves shall be equal to or greater than the reserves required by direct writer. The cession shall be accounted for as provided in the accounting practices and procedures prescribed or permitted by the applicable Accounting Practices and Procedures Manual of the NAIC.

Section 12. Sound Underwriting Practices

A. **Underwriting Review and Approval Required.** All certificates of mortgage guaranty insurance, excluding policies of reinsurance, shall be written based on an assessment of evidence that prudent underwriting standards have been met by the originator of the mortgage. Delegated underwriting decisions shall be reviewed based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the mortgage guaranty insurance company's underwriting standards.

B. **Quality Control Reviews.** Quality control reviews for bulk mortgage guaranty insurance and pool mortgage guaranty insurance shall be based on a reasonable method of sampling of post-closing loan documentation for delegated underwriting decisions to ensure compliance with the representations and warranties of the creditors or creditors originating the loans and with the mortgage guaranty insurance company's underwriting standards.

C. **Minimum Underwriting Standards.** Mortgage guaranty insurance companies shall establish formal underwriting standards which set forth the basis for concluding that prudent underwriting standards have been met.

D. **Underwriting Review and Approval.** A mortgage guaranty insurance company's underwriting standards shall be:

(1) Reviewed and approved by executive management, including, but not limited to the highest-ranking executive officer and financial officer; and

(2) Communicated across the organization to promote consistent business practices with respect to underwriting.

E. **Notification of Changes in Underwriting Standards.** On or before March 1 of each year, a mortgage guaranty insurance company shall file with the domiciliary commissioner changes to its underwriting standards and an analysis of the changes implemented during the course of the immediately preceding year. The annual summary of material underwriting standards changes should include any change associated with loan to value ratios, debt to income ratios, borrower credit standing or maximum loan amount which has resulted in a material impact on net premium written of +/- 5% from prior year to date.

F. **Nondiscrimination.** In extending or issuing mortgage guaranty insurance, a mortgage guaranty insurance company may not discriminate on the basis of the applicant's sex, marital status, race, color, creed, national origin, disability, or age or solely on the basis of the geographic location of the property to be insured unless the discrimination related to geographic location is for a business purpose that is not a mere pretext for unfair discrimination; or the refusal, cancellation, or limitation of the insurance is required by law or regulatory mandate.

Drafting Note: States and jurisdictions should consult their constitution or comparable governance documents and applicable civil rights legislation to determine if broader protections against unacceptable forms of discrimination should be included in Section 12F.

Section 13. Quality Assurance

A. **Quality Assurance Program.** A mortgage guaranty insurance company shall establish a formal internal mortgage guaranty quality assurance program, which provides an early detection warning system as it relates to potential underwriting compliance issues which could potentially impact solvency or operational risk. This mortgage guaranty quality assurance program shall provide for the documentation, monitoring, evaluation and reporting on the integrity of the ongoing loan origination process based on indicators of potential underwriting inadequacies or non-compliance. This shall include, but not limited to:

(1) **Segregation of Duties.** Administration of the quality assurance program shall be delegated to designated risk management, quality assurance or internal audit personnel, who are technically trained and independent from underwriting activities that they audit.

(2) **Senior Management Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to an enterprise risk management committee or other equivalent senior management level oversight body.

(3) **Board of Director Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to the board of directors or a designated committee of directors established to facilitate board of director oversight.

(4) **Policy and Procedures Documentation.** Mortgage guaranty quality assurance program, excluding policies and procedures of reinsurance, shall be formally established and documented to define scope, roles and responsibilities.

(5) **Underwriting Risk Review.** Quality assurance review shall include an examination of underwriting risks including classification of risk and compliance with risk tolerance levels.

(6) **Lender Performance Reviews.** Quality assurance monitoring provisions shall include an assessment of lender performance.

(7) **Underwriting Performance Reviews.** Quality assurance monitoring provisions shall assess compliance with underwriting standard.

(8) **Problem Loan Trend Reviews.** Quality assurance monitoring provisions shall assess prospective risks associated with timely loan payment including delinquency, default inventory, foreclosure and persistency trends.

(9) **Underwriting System Change Oversight.** Underwriting system program changes shall be monitored to ensure the integrity of underwriting and pricing programs, which impact automated underwriting system decision making.

(10) **Pricing and Performance Oversight.** Pricing controls shall be monitored to ensure that business segment pricing supports applicable performance goals.

(11) **Internal Audit Validation.** Periodic internal audits shall be conducted to validate compliance with the mortgage guaranty quality assurance program.

B. **Regulator Access and Review of Quality Assurance Program.** The commissioner shall be provided access to an insurer's mortgage guaranty quality assurance program for review at any reasonable time upon request and during any financial regulatory examination. Nothing herein shall be construed to limit a regulator's right to access any and all of the records of an insurer in an examination or as otherwise necessary to meet regulatory responsibilities.

Section 14. Policy Forms and Premium Rates Filed

A. **Policy Forms.** Policy forms, endorsements, and modifications (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall be filed with and be subject to the approval of the commissioner. With respect to owner-occupied, single-family dwellings or a mixed-use building described in Section 2A(1)(b), which is owner-occupied at the time of loan origination and for at least 50% of the days within the twelve (12) consecutive months prior to borrower default, the borrower shall not be liable to the insurance company for any deficiency arising from a foreclosure sale.

B. **Premium Rates.** Each mortgage guaranty insurance company (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall file with the commissioner the rate to be charged including all modifications.

C. **Premium Charges.** Every mortgage guaranty insurance company shall make available to insureds the premium charges for mortgage guaranty insurance policies via a company website or an integration with a third-party system. The premium rate provided shall show the entire amount of premium charge for the type of mortgage guaranty insurance policy to be issued by the insurance company.

Drafting Note: Open rating states may delete a portion or all of Section 14 and insert their own rating law.

Section 15. Risk in Force and Waivers

A. **Risk in Force.** A mortgage guaranty insurance company shall not at any time have outstanding risk in force, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total risk in force exceeding twenty-five (25) times its capital, surplus and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total risk in force no longer exceeds twenty-five (25) times its capital, surplus and contingency reserve. Total risk in force shall be calculated on an individual entity basis.

B. **Waiver.** The commissioner may waive the requirement found in Section 15A at the written request of a mortgage guaranty insurer upon a finding that the mortgage guaranty insurer's policyholders position is reasonable in relationship to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs. The request must be made in writing at least 90 days in advance of the date that the mortgage guaranty insurer expects to exceed the requirement of Section 15A and shall, at a minimum, address the factors specified in Section 15C.

C. **Waiver Criteria.** In determining whether a mortgage guaranty insurer's policyholders position is reasonable in relation to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs, all of the following factors, among others, may be considered:

(1) The size of the mortgage guaranty insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.

(2) The extent to which the mortgage guaranty insurer's business is diversified across time, geography, credit quality, origination, and distribution channels.

(3) The nature and extent of the mortgage guaranty insurer's reinsurance program.

(4) The quality, diversification, and liquidity of the mortgage guaranty insurer's assets and its investment portfolio.

(5) The historical and forecasted trend in the size of the mortgage guaranty insurer's policyholders position.

(6) The policyholders position maintained by other comparable mortgage guaranty insurers in relation to the nature of their respective insured risks.

(7) The adequacy of the mortgage guaranty insurer's reserves.

(8) The quality and liquidity of investments in affiliates. The c ommissioner may treat any such investment as a nonadmitted asset for purposes of determining the adequacy of surplus as regards policyholders.

(9) The quality of the mortgage guaranty insurer's earnings and the extent to which the reported earnings of the mortgage guaranty insurer include extraordinary items.

(10) An independent actuary's opinion as to the reasonableness and adequacy of the mortgage guaranty insurer's historical and projected policyholders position.

(11) The capital contributions which have been infused or are available for future infusion into the mortgage guaranty insurer.

(12) The historical and projected trends in the components of the mortgage guaranty insurer's aggregate insured risk, including, but not limited to, the quality and type of the risks included in the aggregate insured risk.

D. **Authority to Retain Experts.** The c ommissioner may retain accountants, actuaries, or other experts to assist in the review of the mortgage guaranty insurer's request submitted pursuant to Section 15B. The mortgage guaranty insurer shall bear the commissioner's cost of retaining those persons.

E. **Specified Duration.** Any waiver shall be:

(1) For a specified period of time not to exceed two years; and

(2) Subject to any terms and conditions that the commissioner shall deem best suited to restoring the mortgage guaranty insurer's minimum policyholders position required by Section 15A.

Section 16. Conflict of Interest

A mortgage guaranty insurer may underwrite mortgage guaranty insurance on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate only if the insurance is underwritten on the same basis, for the same consideration and subject to the same insurability requirements as insurance provided to nonaffiliated lenders. Mortgage guaranty insurance underwritten on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate shall be limited to 50% of the insurer's direct premium written in any calendar year, or such higher percentage established in writing for the insurer in the domiciliary commissioner's discretion, based on the domiciliary commissioner's determination that a higher percentage is not likely to adversely affect the financial condition of the insurer.

Section 17. Compensating Balances Prohibited

Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section. Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.

Section 18. Limitations on Rebates, Commissions, Charges and Contractual Preferences

A. **Inducements.** A mortgage guaranty insurance company shall not pay or cause to be paid either directly or indirectly, to any owner, purchaser, lessor, lessee, mortgagee or prospective mortgagee of the real property that secures the authorized real estate security or that is the fee of an insured lease, or any interest therein, or to any person who is acting as an agent, representative, attorney or employee of such owner, purchaser, lessor, lessee or mortgagee, any commission, or any part of its premium charges or any other consideration as an inducement for or as compensation on any mortgage guaranty insurance business.

B. **Compensation for Placement.** In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit the conveyance of anything of value, including but not limited to any commission, fee, premium adjustment, remuneration or other form of compensation of any kind whatsoever to be paid to, or received by an insured lender or lessor; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity in which an insured or an officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing, except for the value of the insurance itself or claim payments thereon as provided by contract or settlement.

C. **Rebates.** A mortgage guaranty insurance company shall not make a rebate of any portion of the premium charge, as shown by the schedule required by Section 14C. No mortgage guaranty insurance company shall not quote any rate or premium charge to a person that is different than that currently available to others for the same type of coverage. The amount by which a premium charge is less than that called for by the current schedule of premium charges is an unlawful rebate.

D. **Undue Contractual Preferences.**

(1) Any contract, letter agreement, or other arrangement used to clarify any terms, conditions, or interpretations of a master policy or certificate shall be documented in writing.

(2) Any contractual or letter agreements used to modify or clarify general business practices and administrative, underwriting, claim submission or other information exchange processes shall not contain provisions which override or significantly undermine the intent of key provisions of the mortgage guaranty insurance model act, including mortgage insurer discretion, rights and responsibilities related to:

(a) Underwriting standards.

(b) Quality assurance.

(c) Rescission.

E. **Sanctions.** The commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company, or in his or her discretion, issue a cease and desist order to a mortgage guaranty insurance company that pays a commission, rebate, or makes any unlawful conveyance of value under this section in willful violation of the provisions of this Act. In the event of the issuance of a cease and desist order, the commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company that does not comply with the terms thereof.

F. **Educational Efforts and Promotional Materials Permitted.** A mortgage guaranty insurance company may engage in any educational effort with borrowers, members of the general public, and officers, directors, employees, contractors and agents of insured lenders that may reasonably be expected to reduce its risk of Loss or promote its operational efficiency and may distribute promotional materials of minor value.

Section 19. Rescission

All mortgage guaranty insurance company master policies shall include a detailed description of provisions governing rescissions, re-pricing, and cancellations, which specify the insurer's and insured's rights, obligations and eligibility terms under which those actions may occur to ensure transparency.

Section 20. Records Retention

A. **Record Files.** A licensed mortgage guaranty insurance company shall maintain its records in a manner which allows the commissioner to readily ascertain the insurer's compliance with state insurance laws and rules during an examination including, but not limited to, records regarding the insurer's management, operations, policy issuance and servicing, marketing, underwriting, rating and claims practices.

B. **Retention Period.** Policy and claim records shall be retained for the period during which the certificate or claim is active plus five (5) years, unless otherwise specified by the insurance commissioner. Recordkeeping requirements shall relate to:

(1) Records to clearly document the application, underwriting, and issuance of each master policy and certificate of insurance; and

(2) Claim records to clearly document the inception, handling, and disposition.

C. **Record Format.** Any record required to be maintained by a mortgage insurer may be created and stored in the form of paper, photograph, magnetic, mechanical or electronic medium.

D. **Record Maintenance.** Record maintenance under this Act shall comply with the following requirements:

(1) Insurer maintenance responsibilities shall provide for record storage in a location that will allow the records to be reasonably produced for examination within the time period required.

(2) Third-Party maintenance related responsibilities shall be set forth in a written agreement, a copy of which shall be maintained by the insurer and available for purposes of examination.

Section 21. Regulations

The commissioner shall have the authority to promulgate rules and regulations deemed necessary to effectively implement the requirements of this Act.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

1976 Proc. II 15, 17, 647, 686, 747-753 (adopted).
1979 Proc. I 44, 47-48, 49, 719, 968-969 (corrected).

PROJECT HISTORY – 2023

MORTGAGE GUARANTY INSURANCE MODEL ACT (#630)

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

The current NAIC *Mortgage Guaranty Insurance Model Act* (#630) was first adopted in 1976 and amended in 1979. Model #630 was created to provide effective regulation and supervision of mortgage guaranty insurers. Model #630 defines mortgage guaranty insurance as insurance against financial loss by reason of nonpayment of principal, interest, or other sums agreed to be paid on any note secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate. Mortgage guaranty insurance may also cover against financial loss by reason of nonpayment of rent under the terms of a written lease. As of April 2012, eight states had adopted the most recent version of the model in a substantially similar manner. An additional 12 states have adopted an older version of the model, legislation, or regulation derived from other sources such as bulletins and administrative rulings.

The Mortgage Guaranty Insurance (E) Working Group was formed in November 2012. By early 2013, the Working Group developed a list of potential regulatory changes to Model #630 to address changes in mortgage lending and mortgage finance since the model's original approval in the 1970s and to respond to the lessons learned during the 2008 national recession and housing market downturn. As a result, a Request for NAIC Model Law Development was made and approved by the Executive (EX) Committee at the 2013 Summer National Meeting.

Development of the modernized model has a long history dating back to the fall of 2012. At that time, development of a capital model to accompany Model #630 was the key focus of attention. During 2013, mortgage guaranty insurers engaged Oliver Wyman to begin working on a Mortgage Guaranty Capital Model. Over the next several years, the Mortgage Guaranty Capital Model was developed. It was determined in December 2016 that a secondary contractor would need to be hired to further assess the reliability of the Mortgage Guaranty Capital Model. In September 2017, Milliman began its work to review and validate the Mortgage Guaranty Capital Model.

In March 2018, Milliman provided its assessment of the capital model to the Working Group. It indicated that inconsistencies and errors were found in the data preparation steps used to: 1) estimate the capital model coefficients and the application of the same capital model coefficients; and 2) forecast future loan performance. Milliman stated that these inconsistencies and errors were material to the capital model and would need to be addressed before the Mortgage Guaranty Capital Model could be implemented.

As a result, Milliman continued its work on the Mortgage Guaranty Capital Model, and in December 2019, it was exposed for public comment. The comments regarding the exposure were expected to be discussed during the 2020 Spring National Meeting. However, due to the COVID-19 pandemic, this meeting was cancelled. The Working Group also began working on an annual statement exhibit to begin collecting data for the capital model. In April 2021, the Mortgage Guaranty Insurance (E) Working Group referred the exhibit proposal to the Blanks (E) Working Group. The exhibit was finalized and implemented into the blank effective year-end 2021. In May 2022, the Mortgage Guaranty Insurance (E) Working Group decided to pause the development of the capital model and continue collecting data for further analysis in the future. As a result, the Working Group focused on finalizing the model.

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

The Mortgage Guaranty Insurance (E) Working Group comprised the drafting Group and consisted of the following states during 2023: North Carolina (chair); Arizona; California; Florida, Missouri, New York, Pennsylvania; Texas; and Wisconsin.

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

The Executive (EX) Committee approved the Request for NAIC Model Law Development during the 2013 Summer National Meeting. Throughout the course of model development, the Financial Condition (E) Committee chair approved extensions due to extenuating circumstances.

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 Working Group formed a drafting group, which consisted of: Jackie Obusek (NC–Chair); Kurt Regner (AZ); Monica Macaluso (CA); Robert Ballard (FL); John Rehagen (MO); Margot Small (NY); Melissa Greiner (PA); Amy Garcia (TX); and Amy Malm (WI). Following the lengthy hiatus from the development of the model, due to work being completed on the Mortgage Guaranty Capital Model, the drafting group began finalization of model in May 2022 without consideration of the capital model. During its May meeting, the drafting group discussed the overall approach to finalizing the model and a rather aggressive timeline for completion.

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)

The Working Group met in open session on Oct. 6 and Dec. 13, 2022, and March 22, 2023. During these sessions, interested regulators and parties submitted comment letters to the Working Group. The drafting group held nine regulator-only discussion and planning calls between May 2022 and March 2023. The Working Group exposed the model for public comment on Oct. 7, 2022, and again on Feb. 27, 2023, and May 11, 2023. Comments were received from: the California Department of Insurance (DOI); the Center for Economic Justice (CEJ); and the Mortgage Guaranty Consortium (Arch Mortgage Insurance Company, Enact Mortgage Insurance Corporation, Essent Guaranty Inc., Mortgage Guaranty Insurance Corporation, National Mortgage Insurance Corporation, and Radian Guaranty Inc).

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

Section 10, Reserve Requirements – Contingency Reserve
The most significant issue raised during development was related to the recording of the contingency reserves when reinsurance is used. The specific provision is: "The Mortgage Guaranty Insurance company shall make an annual contribution to the Contingency Reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve." The mortgage insurers indicated that many reinsurers do not complete a statutory financial statement and would not have the ability to record the contingency reserve. The drafting group members discussed the topic and agreed to leave the provision as stated.

Section 21, No Private Right of Action Provision

The mortgage guaranty insurers proposed the following provision for inclusion in the model: "No Private Right of Action. Nothing in this Act is intended to, or does, create a private right of action based upon compliance or noncompliance with any of the Act's provisions. Authority to enforce compliance with this Act is vested exclusively in the Commissioner." Following discussion by the drafting group, the provision was added to the model and included in the Feb. 27, 2023, exposure. The drafting group received several comments on the provision. Following discussion, Section 21 was removed from the model.

7. List the Key Provisions of the Model (sections considered most essential to state adoption)

Section 10. Reserve Requirements

A. **Unearned Premium Reserves, Loss Reserves, and Premium Deficiency Reserves.** Financial reporting will be prepared in accordance with the *Accounting Practices and Procedures Manual* (AP&P Manual) and Annual Financial Statement Instructions of the NAIC.

B. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:

(1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve, which, in the aggregate, shall be equal to 50% of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.

(2) Except as provided within this act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months to provide for reserve buildup. The portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.

(3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis or such other basis, with the prior written approval of the domiciliary commissioner, based on the amount by which:

(a) Incurred losses and loss adjustment expenses exceed 35% of the direct earned premium in any year. Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal as adjusted for the quarterly nature of the withdrawal; or

(b) Upon the approval of the domiciliary commissioner and 30-day prior notification to non-domiciliary commissioners, a mortgage guaranty insurer may withdraw from the contingency reserve any amounts that are in excess of the requirements of Section 15 as required in (insert section of the mortgage guaranty insurance model law requiring minimum policyholder's position) as filed with the most recently filed annual statement.

(i.) The mortgage guaranty insurance company's domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.

C. **Miscellaneous.**

(1) Unearned premium reserves and contingency reserves on risks insured before the effective date of this act may be computed and maintained as required previously.

Section 15. Risk in Force and Waivers

A. **Risk in Force.** A mortgage guaranty insurance company shall not at any time have outstanding risk in force, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding 25 times its capital, surplus, and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total risk in force exceeding 25 times its capital, surplus, and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total risk in force no longer exceeds 25 times its capital, surplus, and contingency reserve. Total risk in force shall be calculated on an individual entity basis.

B. **Waiver.** The commissioner may waive the requirement found in subsection (a) of this section at the written request of a mortgage guaranty insurer upon a finding that the mortgage guaranty insurer's policyholders position is reasonable in relationship to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs. The request must be made in writing at least 90 days in advance of the date that the mortgage guaranty insurer expects to exceed the requirement of subsection (a) of this section and shall, at a minimum, address the factors specified in subsection (j) of this section.

C. **Waiver Criteria.** In determining whether a mortgage guaranty insurer's policyholders position is reasonable in relation to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs, all of the following factors, among others, may be considered:

(1) The size of the mortgage guaranty insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.

(2) The extent to which the mortgage guaranty insurer's business is diversified across time, geography, credit quality, origination, and distribution channels.

(3) The nature and extent of the mortgage guaranty insurer's reinsurance program.

(4) The quality, diversification, and liquidity of the mortgage guaranty insurer's assets and its investment portfolio.

(5) The historical and forecasted trend in the size of the mortgage guaranty insurer's policyholders position.

(6) The policyholders position maintained by other comparable mortgage guaranty insurers in relation to the nature of their respective insured risks.

(7) The adequacy of the mortgage guaranty insurer's reserves.

(8) The quality and liquidity of investments in affiliates. The commissioner may treat any such investment as a nonadmitted asset for purposes of determining the adequacy of surplus as regards policyholders.

(9) The quality of the mortgage guaranty insurer's earnings and the extent to which the reported earnings of the mortgage guaranty insurer include extraordinary items.

(10) An independent actuary's opinion as to the reasonableness and adequacy of the mortgage guaranty insurer's historical and projected policyholders position.

(11) The capital contributions that have been infused or are available for future infusion into the mortgage guaranty insurer.

(12) The historical and projected trends in the components of the mortgage guaranty insurer's aggregate insured risk, including the quality and type of the risks included in the aggregate insured risk.

D. **Authority to Retain Experts.** The commissioner may retain accountants, actuaries, or other experts to assist the commissioner in the review of the mortgage guaranty insurer's request submitted pursuant to subsection (i) of this section. The mortgage guaranty insurer shall bear the commissioner's cost of retaining those persons.

E. **Specified Duration.** Any waiver shall be (i) for a specified period of time not to exceed two years and (ii) subject to any terms and conditions that the commissioner shall deem best suited to restoring the mortgage guaranty insurer's minimum policyholders position required by subsection (a) of this section.

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

None. It is not an accreditation standard, and the Working Group is not making a recommendation that it be considered as an accreditation standard.

Draft: [May 11, 2023]
Adopted by Mortgage Guaranty Insurance (E) Working Group—[July 13, 2023]
Adopted by [insert parent committee]—[insert date]

MORTGAGE GUARANTY INSURANCE MODEL ACT

Table of Contents

Section 1. Title

This Act may be cited as the Mortgage Guaranty Insurance Act.

Section 2. Definitions

The definitions set forth in this Act shall govern the construction of the terms used in this Act but shall not affect any other provisions of the code.

A. ~~A.~~ "Authorized ~~real estate security," for the purpose of this Act,~~Real Estate Security" means ~~an~~:

(1) An amortized note, bond or other ~~evidence~~instrument of indebtedness, except for reverse mortgage loans made pursuant to [insert citation of state law that authorizes reverse mortgages] of the real property law, evidencing a loan, not exceeding ~~ninety-five~~one hundred three percent (~~95~~103%) of the fair market value of the real estate, secured by a mortgage, deed of trust, or other instrument that constitutes, or is equivalent to, a first lien or ~~charge on real estate~~junior lien or charge on real estate, with any percentage in excess of one hundred percent (100%) being used to finance the fees and closing costs on such indebtedness; provided:

(a) ~~(1)~~ The real estate loan secured in this manner is one of a type that a ~~bank, savings and loan association, or an insurance company~~creditor, which is supervised and regulated by a department of ~~this~~any state or territory of the U.S or an agency of the federal government, is authorized to make, or would be authorized to make, disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate;

(~~2~~b) The ~~improvement on~~loan is to finance the acquisition, initial construction or refinancing of real estate that is a:

(i) Residential building designed for occupancy by not more than four families, a one-family residential condominium or unit in a planned unit development, or any other one-family residential unit as to which title may be conveyed freely; or

(ii) Mixed-use building with only one non-residential use and one one-family dwelling unit; or

(iii) Building or buildings designed for occupancy ~~as specified by Subsections A(1) and A(2) of this section; and~~by five (5) or more families or designed to be occupied for industrial or commercial purposes.

(~~3~~c) The lien on the real estate may be subject to and subordinate to ~~the following:~~

~~(a) The lien of any public bond, assessment or tax, when no installment, call or payment of or under the bond, assessment or tax is delinquent; and~~
~~(b) Outstanding mineral, oil, water or timber~~other liens, leases, rights, ~~rights of way, easements or rights of way of support, sewer rights, building~~ restrictions ~~or other restrictions or~~, easements, covenants, conditions or regulations of use~~, or outstanding leases upon the real property under which rents or profits are reserved to the owner thereof~~ that do not impair the use of the real estate for its intended purpose.

(2) Notwithstanding the foregoing, a loan referenced in Section 2A(1) of this Act may exceed 103% of the fair market value of the real estate in the event that the mortgage guaranty insurance company has approved for loss mitigation purposes a request to refinance a loan that constitutes an existing risk in force for the company.

(3) An amortized note, bond or other instrument of indebtedness evidencing a loan secured by an ownership interest in, and a proprietary lease from, a corporation or partnership formed for the purpose of the cooperative ownership of real estate and at the time the loan does not exceed one hundred three percent (103%) of the fair market value of the ownership interest and proprietary lease, if the loan is one of a type that meets the requirements of Section 2A(1)(a), unless the context clearly requires otherwise, any reference to a mortgagor shall include an owner of such an ownership interest as described in this paragraph and any reference to a lien or mortgage shall include the security interest held by a lender in such an ownership interest.

B. "Bulk Mortgage Guaranty Insurance" means mortgage guaranty insurance that provides coverage under a single transaction on each mortgage loan included in a defined portfolio of loans that have already been originated.

C. "Certificate of Insurance" means a document issued by a mortgage guaranty insurance company to the initial insured to evidence that it has insured a particular authorized real estate security under a master policy, identifying the terms, conditions and representations, in addition to those contained in the master policy and endorsements, applicable to such coverage.

D. ~~"Commissioner" means [insert the title of the principal insurance supervisory official] of this state, or the [insert the title of the principal insurance supervisory official]'s deputies or assistants, or any employee of the [insert name of the principal insurance regulatory agency] of this state acting in the [insert the title of the principal insurance supervisory official]'s name and by the [insert the title of the principal insurance supervisory official]'s delegated authority.~~"Commissioner." The term "commissioner" shall mean the insurance commissioner, the commissioner's deputies, or the Insurance Department, as appropriate.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the word "commissioner" appears.

E.

~~B.~~ ~~"Contingency reserve~~"Contingency Reserve" means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.

~~C. "Mortgage guaranty insurance" is~~F. "Domiciliary Commissioner" means the principal insurance supervisory official of the jurisdiction in which a mortgage guaranty insurance company is domiciled~~, or that principal insurance supervisory official's deputies or assistants, or any employee of the regulatory agency of which that principal insurance supervisory official is the head acting in that principal insurance supervisory official's name and by that principal insurance supervisory official's delegated authority~~.

G. "Effective Guaranty" refers to the assumed backing of existing or future holders of securities by virtue of their issuer's conservatorship or perceived access to credit from the U.S. Treasury, as opposed to the direct full faith and credit guarantee provided by the U.S. government.

H. "Loss" refers to losses and loss adjustment expenses.

I. "Master Policy" means a document issued by a mortgage guaranty insurance company that establishes the terms and conditions of mortgage guaranty insurance coverage provided thereunder, including any endorsements thereto.

J. "Mortgage Guaranty ~~:~~

~~(1)~~ Insurance" is insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any ~~note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, provided the improvement on the real estate is a residential building or a condominium unit or buildings designed for occupancy by not more than four families;~~authorized real estate security.

~~(2) Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, providing the improvement on the real estate is a building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes; and~~

~~(3) Insurance against financial loss by reason of nonpayment of rent or other sums agreed to be paid under the terms of a written lease for the possession, use or occupancy of real estate, provided the improvement on the real estate is a building or buildings designed to be occupied for industrial or commercial purposes.~~

K. "Mortgage Guaranty Quality Assurance Program" means an early detection warning system for potential underwriting compliance issues which could potentially impact solvency or operational risk within a mortgage guaranty insurance company.

L. "NAIC" means the National Association of Insurance Commissioners.

M. "Pool Mortgage Guaranty Insurance" means mortgage guaranty insurance that provides coverage under a single transaction or a defined series of transactions on a defined portfolio of loans for losses up to an aggregate limit.

N. "Right of Rescission" represents a remedy available to a mortgage guaranty insurance company to void a certificate and restore parties to their original position, based on inaccurate, incomplete or misleading information provided to, or information omitted or concealed from, the mortgage guaranty insurance company in connection with the insurance application, resulting in an insured loan that did not meet the mortgage guaranty insurance company's eligibility requirements in effect on the date of submission of the insurance application.

O. "Risk in Force" means the mortgage guaranty insurance coverage percentage applied to the unpaid principal balance.

Section 3. Insurer's Authority to Transact Business

A company may not transact the business of mortgage guaranty insurance until it has obtained a certificate of authority from the commissioner.

Section 4. Mortgage Guaranty Insurance as Monoline

A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.

Section 5. Risk Concentration

A mortgage guaranty insurance company shall not expose itself to any loss on any one authorized real estate security risk in an amount exceeding ten percent (10%) of its surplus to policyholders. Any risk or portion of risk which has been reinsured shall be deducted in determining the limitation of risk.

Section 6. Capital and Surplus

A. **Initial and Minimum Capital and Surplus Requirements.** A mortgage guaranty insurance company shall not transact the business of mortgage guaranty insurance unless, if a stock insurance company, it has paid-in capital of at least $~~1~~10,000,000 and paid-in surplus of at least $~~1~~15,000,000, or if a mutual insurance company, a minimum initial surplus of $~~2~~25,000,000. A stock insurance company or a mutual insurance company shall at all times thereafter maintain a minimum policyholders' surplus of at least $~~1,500~~20,000,000.

~~**Section 4. Insurer's Authority to Transact Business**~~

~~No mortgage guaranty insurance company may issue policies until it has obtained from the commissioner of insurance a certificate setting forth that fact and authorizing it to issue policies.~~

B. ~~**Section 5.**~~ **Minimum Capital Requirements Applicability.** A mortgage guaranty insurance company formed prior to the passage of this Act may maintain the amount of capital and surplus or minimum policyholders' surplus previously required by statute or administrative order for a period not to exceed twelve months following the effective date of the adoption of this Act.

C. **Minimum Capital Requirements Adjustments.** The domiciliary commissioner may by order reduce the minimum amount of capital and surplus or minimum policyholders' surplus required under Section 6A under the following circumstances:

(1) For an affiliated reinsurer that is a mortgage guaranty insurance company and that is or will be engaged solely in the assumption of risks from affiliated mortgage guaranty insurance companies, provided that the affiliated reinsurer is in run-off and, in the domiciliary commissioner's opinion, the business plan and other relevant circumstances of the affiliated reinsurer justify the proposed reduction in requirements.

(2) For mortgage guaranty insurance companies that are in run-off and not writing new business that is justified in a business plan, in the domiciliary commissioner's opinion.

Section 7. Geographic Concentration

A. A mortgage guaranty insurance company shall not insure loans secured by a single risk in excess of ten percent (10%) of the company's aggregate capital, surplus and contingency reserve.

B. No mortgage guaranty insurance company shall have more than twenty percent (20%) of its total insurance in force in any one Standard Metropolitan Statistical Area (SMSA), as defined by the ~~United States~~U.S Department of Commerce.

C. The provisions of this section shall not apply to a mortgage guaranty insurance company until it has possessed a certificate of authority in this state for three (3) years.

Section ~~6~~8. Advertising

No mortgage guaranty insurance company or an agent or representative of a mortgage guaranty insurance company shall prepare or distribute or assist in preparing or distributing any ~~brochure, pamphlet, report or any form of~~ advertising media or communication to the effect that the real estate investments of any financial institution are "insured investments," unless the ~~brochure, pamphlet, report or~~ advertising media or communication clearly states that the loans are insured by mortgage guaranty insurance companies possessing a certificate of authority to transact mortgage guaranty insurance in this state or are insured by an agency of the federal government~~, as the case may be~~.

Section ~~7~~9. Investment Limitation

~~A mortgage guaranty insurance company shall not invest~~Investments in notes or other evidence~~s~~ of indebtedness secured by a mortgage or other liens upon residential real property shall not be allowed as assets in any determination of the financial condition of a mortgage guaranty insurer. This section shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contract~~s~~ of sale are acquired in the course of ~~the~~ good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property so acquired. This section shall not apply to investments backed by the full faith and credit of the U.S. Government or investments with the effective guaranty of the U.S. Government. This section shall not apply to investments held by a mortgage guaranty insurance company prior to the passage of this Act.

Section ~~8. Coverage Limitation~~10. Reserve Requirements

A. **Unearned premium Reserves, Loss Reserves, and Premium Deficiency Reserves.** Financial reporting will be prepared in accordance with the Accounting Practices and Procedures Manual and Annual Financial Statement Instructions of the NAIC.

B. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:

(1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.

(2) Except as provided within this Act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, to provide for reserve buildup. The portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.

(3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis or such other basis, with the prior written approval of the domiciliary commissioner, based on the amount by which:

(a) Incurred losses and loss adjustment expenses exceed 35% of the direct earned premium in any year. Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal as adjusted for the quarterly nature of the withdrawal; or

(b) Upon the approval of the domiciliary commissioner and 30-day prior notification to non-domiciliary commissioners, a mortgage guaranty insurer may withdraw from the contingency reserve any amounts which are in excess of the requirements of Section 15 as required in [insert section of the mortgage guaranty Insurance model law requiring minimum policyholder's position] as filed with the most recently filed annual statement.

(i) The mortgage guaranty insurance company's domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.

C. **Miscellaneous.** Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.

Section 11. Reinsurance

A. **Prohibition of Captive Reinsurance.** A mortgage guaranty insurance company shall not enter into captive reinsurance arrangements which involve the direct or indirect ceding of any portion of its insurance risks or obligations to a reinsurer owned or controlled by an insured; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity owned or controlled by an insured or an insured's officer, director or employee or any member of their immediate family that has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

B. **Reinsurance Cessions.** A mortgage guaranty insurer may, by written contract, reinsure any insurance that it transacts, except that no mortgage guaranty insurer may enter into reinsurance arrangements designed to circumvent the compensating control provisions of Section 17 or the contingency reserve requirement of Section 10. The unearned premium reserve and the loss reserves required by Section 10 shall be established and maintained by the direct insurer or by the assuming reinsurer so that the aggregate reserves shall be equal to or greater than the reserves required by direct writer. The cession shall be accounted for as provided in the accounting practices and procedures prescribed or permitted by the applicable Accounting Practices and Procedures Manual of the NAIC.

Section 12. Sound Underwriting Practices

A. **Underwriting Review and Approval Required.** All certificates of mortgage guaranty insurance, excluding policies of reinsurance, shall be written based on an assessment of evidence that prudent underwriting standards have been met by the originator of the mortgage. Delegated underwriting decisions shall be reviewed based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the mortgage guaranty insurance company's underwriting standards.

B. **Quality Control Reviews.** Quality control reviews for bulk mortgage guaranty insurance and pool mortgage guaranty insurance shall be based on a reasonable method of sampling of post-closing loan documentation for delegated underwriting decisions to ensure compliance with the representations and warranties of the creditors or creditors originating the loans and with the mortgage guaranty insurance company's underwriting standards.

C. **Minimum Underwriting Standards.** Mortgage guaranty insurance companies shall establish formal underwriting standards which set forth the basis for concluding that prudent underwriting standards have been met.

D. **Underwriting Review and Approval.** A mortgage guaranty insurance company's underwriting standards shall be:

(1) ~~A mortgage guaranty insurance company shall limit its coverage net of reinsurance ceded to a reinsurer in which the company has no interest to a maximum of twenty-five percent (25%) of the entire indebtedness to the insured or in lieu thereof, a mortgage guaranty insurance company may elect to pay the entire indebtedness to the insured and acquire title to the authorized real estate security.~~

~~**Section 9.**~~ Reviewed and approved by executive management, including, but not limited to the highest-ranking executive officer and financial officer; and

(2) Communicated across the organization to promote consistent business practices with respect to underwriting.

E. **Notification of Changes in Underwriting Standards.** On or before March 1 of each year, a mortgage guaranty insurance company shall file with the domiciliary commissioner changes to its underwriting standards and an analysis of the changes implemented during the course of the immediately preceding year. The annual summary of material underwriting standards changes should include any change associated with loan to value ratios, debt to income ratios, borrower credit standing or maximum loan amount which has resulted in a material impact on net premium written of +/- 5% from prior year to date.

Nondiscrimination. In extending or issuing mortgage guaranty insurance, a mortgage guaranty insurance company

~~A. A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.~~

~~B. A mortgage guaranty insurance that anywhere transacts the classes of insurance defined in Section 2A(2) or 2A(3) is not eligible for a certificate of authority to transact in this state the class of mortgage guaranty insurance defined in Section 2A(1). However, a mortgage guarantee insurance company that transacts a class of insurance defined in Section 2A may write up to five percent (5%) of its insurance in force on residential property designed for occupancy by five (5) or more families.~~

~~**Section 10. Underwriting Discrimination**~~

~~A. Nothing in this chapter shall be construed as limiting the right of a mortgage guaranty insurance company to impose reasonable requirements upon the lender with regard to the terms of a note or bond or other evidence of indebtedness secured by a mortgage or deed of trust, such as requiring a stipulated down payment by the borrower~~may not ~~.~~

F. ~~B. No mortgage guaranty insurance company may~~ discriminate ~~in the issuance or extension of mortgage guaranty insurance on the~~ on the basis of the applicant's sex, marital status, race, color, creed ~~or national origin~~, national origin, disability, or age or solely on the basis of the geographic location of the property to be insured unless the discrimination related to geographic location is for a business purpose that is not a mere pretext for unfair discrimination; or the refusal, cancellation, or limitation of the insurance is required by law or regulatory mandate.

~~C. No policy~~**Drafting Note**: States and jurisdictions should consult their constitution or comparable governance documents and applicable civil rights legislation to determine if broader protections against unacceptable forms of discrimination should be included in Section 12F.

Section 13. ~~mortgage guaranty insurance~~**Quality Assurance**

A. **Quality Assurance Program.** A mortgage guaranty insurance company shall establish a formal internal mortgage guaranty quality assurance program, which provides an early detection warning system as it relates to potential underwriting compliance issues which could potentially impact solvency or operational risk. This mortgage guaranty quality assurance program shall provide for the documentation, monitoring, evaluation and reporting on the integrity of the ongoing loan origination process based on indicators of potential underwriting inadequacies or non-compliance. This shall include, but not limited to:

(1) **Segregation of Duties.** Administration of the quality assurance program shall be delegated to designated risk management, quality assurance or internal audit personnel, who are technically trained and independent from underwriting activities that they audit.

(2) **Senior Management Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to an enterprise risk management committee or other equivalent senior management level oversight body.

(3) **Board of Director Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to the board of directors or a designated committee of directors established to facilitate board of director oversight.

(4) **Policy and Procedures Documentation.** Mortgage guaranty quality assurance program, excluding policies and procedures of reinsurance, shall be formally established and documented to define scope, roles and responsibilities.

(5) **Underwriting Risk Review.** Quality assurance review shall include an examination of underwriting risks including classification of risk and compliance with risk tolerance levels.

(6) **Lender Performance Reviews.** Quality assurance monitoring provisions shall include an assessment of lender performance.

(7) **Underwriting Performance Reviews.** Quality assurance monitoring provisions shall assess compliance with underwriting standard.

(8) **Problem Loan Trend Reviews.** Quality assurance monitoring provisions shall assess prospective risks associated with timely loan payment including delinquency, default inventory, foreclosure and persistency trends.

(9) **Underwriting System Change Oversight.** Underwriting system program changes shall be monitored to ensure the integrity of underwriting and pricing programs, which impact automated underwriting system decision making.

(10) **Pricing and Performance Oversight.** Pricing controls shall be monitored to ensure that business segment pricing supports applicable performance goals.

(11) **Internal Audit Validation.** Periodic internal audits shall be conducted to validate compliance with the mortgage guaranty quality assurance program.

B. **Regulator Access and Review of Quality Assurance Program.** The commissioner shall be provided access to an insurer's mortgage guaranty quality assurance program for review at any reasonable ~~and thorough examination of the evidence supporting credit worthiness of the borrower and the appraisal report reflecting market evaluation of the property and has determined that prudent underwriting standards have been met~~time upon request and during any financial regulatory examination. Nothing herein shall be construed to limit a regulator's right to access any and all of the records of an insurer in an examination or as otherwise necessary to meet regulatory responsibilities.

Section ~~11~~14. Policy Forms and Premium Rates Filed

A. **Policy Forms.** ~~All~~ Ppolicy forms ~~and~~, endorsements, and modifications (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall be filed with and be subject to the approval of the commissioner. With respect to owner-occupied, single-family dwellings~~, the mortgage guaranty insurance policy shall provide that~~ or a mixed-use building described in Section 2A(1)(b), which is owner-occupied at the time of loan origination and for at least 50% of the days within the twelve (12) consecutive months prior to borrower default, the borrower shall not be liable to the insurance company for any deficiency arising from a foreclosure sale.

B. ~~In addition, each mortgage guaranty insurance~~**Premium Rates.** Each mortgage guaranty insurance company (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall file with the ~~department~~commissioner the rate to be charged ~~and the premium~~ including all modifications ~~of rates and premiums to be paid by the policyholder~~.

C. **Premium Charges.** Every mortgage guaranty insurance company shall ~~adopt, print and~~ make available ~~a schedule of~~to insureds the premium charges for mortgage guaranty insurance policies~~. Premium charges made in conformity~~ via a company website or an integration with ~~the provisions of this Act shall not be deemed to be interest or other charges under any other provision of law limiting interest or other charges in connection with mortgage loans.~~ a third-party system. The ~~schedule~~premium rate provided shall show the entire amount of premium charge for ~~each~~the type of mortgage guaranty insurance policy to be issued by the insurance company.

Drafting Note: Open rating states may delete a portion or all of ~~this provision~~Section 14 and insert their own rating law.

Section ~~12. Outstanding Total Liability~~15. Risk in Force and Waivers

A. ~~A mortgage guaranty insurance~~ **Risk in Force.** A mortgage guaranty insurance company shall not at any time have outstanding ~~a total liability~~risk in force, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total ~~liability~~risk in force exceeding twenty-five (25) times its capital, surplus and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total ~~liability~~risk in force no longer exceeds twenty-five (25) times its capital, surplus and contingency reserve. Total ~~outstanding liability~~risk in force shall be calculated on ~~a consolidated~~an individual entity basis ~~for all mortgage guarantee insurance companies~~.

B. **Waiver.** The commissioner may waive the requirement found in Section 15A at the written request of a mortgage guaranty insurer upon a finding that ~~are part of a holding company system~~the mortgage guaranty insurer's policyholders position is reasonable in relationship to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs. The request must be made in writing at least 90 days in advance of the date that the mortgage guaranty insurer expects to exceed the requirement of Section 15A and shall, at a minimum, address the factors specified in Section 15C.

C. **Waiver Criteria.** In determining whether a mortgage guaranty insurer's policyholders position is reasonable in relation to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs, all of the following factors, among others, may be considered:

(1) The size of the mortgage guaranty insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.

(2) The extent to which the mortgage guaranty insurer's business is diversified across time, geography, credit quality, origination, and distribution channels.

(3) The nature and extent of the mortgage guaranty insurer's reinsurance program.

The quality, diversification, and liquidity of the

(4) mortgage guaranty insurer's assets and its investment portfolio.

(5) The historical and forecasted trend in the size of the mortgage guaranty insurer's policyholders position.

(6) The policyholders position maintained by other comparable mortgage guaranty insurers in relation to the nature of their respective insured risks.

(7) The adequacy of the mortgage guaranty insurer's reserves.

(8) The quality and liquidity of investments in affiliates. The c ommissioner may treat any such investment as a nonadmitted asset for purposes of determining the adequacy of surplus as regards policyholders.

(9) The quality of the mortgage guaranty insurer's earnings and the extent to which the reported earnings of the mortgage guaranty insurer include extraordinary items.

(10) An independent actuary's opinion as to the reasonableness and adequacy of the mortgage guaranty insurer's historical and projected policyholders position.

(11) The capital contributions which have been infused or are available for future infusion into the mortgage guaranty insurer.

(12) The historical and projected trends in the components of the mortgage guaranty insurer's aggregate insured risk, including, but not limited to, the quality and type of the risks included in the aggregate insured risk.

D. **Authority to Retain Experts.** The commissioner may retain accountants, actuaries, or other experts to assist in the review of the mortgage guaranty insurer's request submitted pursuant to Section 15B. The mortgage guaranty insurer shall bear the commissioner's cost of retaining those persons.

E. **Specified Duration.** Any waiver shall be:

(1) For a specified period of time not to exceed two years; and

(2) Subject to any terms and conditions that the commissioner shall deem best suited to restoring the mortgage guaranty insurer's minimum policyholders position required by Section 15A.

Section 16. Conflict of Interest

A mortgage guaranty insurer may underwrite mortgage guaranty insurance on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate only if the insurance is underwritten on the same basis, for the same consideration and subject to the same insurability requirements as insurance provided to nonaffiliated lenders. Mortgage guaranty insurance underwritten on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate shall be limited to 50% of the insurer's direct premium written in any calendar year, or such higher percentage established in writing for the insurer in the domiciliary commissioner's discretion, based on the domiciliary commissioner's determination that a higher percentage is not likely to adversely affect the financial condition of the insurer.

Section 17. Compensating Balances Prohibited

Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section. Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.

Section 18. Limitations on Rebates, Commissions, Charges and Contractual Preferences

A. ~~insurance~~**Inducements.** A mortgage guaranty insurance company shall not pay or cause to be paid either directly or indirectly, to any owner, purchaser, lessor, lessee, mortgagee or prospective mortgagee of the real property that secures the authorized real estate security or that is the fee of an insured lease, or any interest therein, or to any person who is acting as an agent, representative, attorney or employee of such owner, purchaser, lessor, lessee or mortgagee, any commission, or any part of its premium charges or any other consideration as an inducement for or as compensation on any mortgage guaranty insurance business.

B. **Compensation for Placement.** In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit the conveyance of anything of value, including but not limited to any commission, fee, premium adjustment, remuneration or other form of compensation of any kind whatsoever to be paid to, or received by an insured lender or lessor; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity in which an insured or an officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing, except for the value of the insurance itself or claim payments thereon as provided by contract or settlement.

C. ~~C. No mortgage guaranty insurance~~**Rebates.** A mortgage guaranty insurance company shall not make a rebate of any portion of the premium charge, as shown by the schedule required by Section ~~11C. No mortgage guaranty insurance~~14C. No mortgage guaranty insurance company shall not quote any rate or premium charge to a person that is different than that currently available to others for the same type of coverage. The amount by which a premium charge is less than that called for by the current schedule of premium charges is an unlawful rebate.

D. **Undue Contractual Preferences.**

(1) Any contract, letter agreement, or other arrangement used to clarify any terms, conditions, or interpretations of a master policy or certificate shall be documented in writing.

(2) Any contractual or letter agreements used to modify or clarify general business practices and administrative, underwriting, claim submission or other information exchange processes shall not contain provisions which override or significantly undermine the intent of key provisions of the mortgage guaranty insurance model act, including mortgage insurer discretion, rights and responsibilities related to:

(a) Underwriting standards.

(b) Quality assurance.

(c) Rescission.

E. **Sanctions.** The commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company, or in his or her discretion, issue a cease and desist order to a mortgage guaranty insurance company that pays a commission, rebate, or makes any unlawful ~~rebate~~conveyance of value under this section in willful violation of the provisions of this Act. In the event of the issuance of a cease and desist order, the commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company that does not comply with the terms thereof.

~~**Section 14. Compensating Balances Prohibited**~~

F. ~~Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section.~~ **Educational Efforts and Promotional Materials Permitted.** A mortgage guaranty insurance company may engage in any educational effort with borrowers, members of the general public, and officers, directors, employees, contractors and agents of insured lenders that may reasonably be expected to reduce its risk of Loss or promote its operational efficiency and may distribute promotional materials of minor value.

Section 19. Rescission

All mortgage guaranty insurance company master policies shall include a detailed description of provisions governing rescissions, re-pricing, and cancellations, which specify the insurer's and insured's rights, obligations and eligibility terms under which those actions may occur to ensure transparency.

Section 20. Records Retention

A. **Record Files.** A licensed mortgage guaranty insurance company shall maintain its records in a manner which allows the commissioner to readily ascertain the insurer's compliance with state insurance laws and rules during an examination including, but not limited to, records regarding the insurer's management, operations, policy issuance and servicing, marketing, underwriting, rating and claims practices.

B. ~~Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.~~

~~**Section 15.**~~ **Retention Period.** Policy and claim records shall be retained for the period during which the certificate or claim is active plus five (5) years, unless otherwise specified by the insurance commissioner. Recordkeeping requirements shall relate to:

(1) Records to clearly document the application, underwriting, and issuance of each master policy and certificate of insurance; and

(2) Claim records to clearly document the inception, handling, and disposition.

C. **Record Format.** Any record required to be maintained by a mortgage insurer may be created and stored in the form of paper, photograph, magnetic, mechanical or electronic medium.

D. **Record Maintenance.** Record maintenance under this Act shall comply with the following requirements:

(1) Insurer maintenance responsibilities shall provide for record storage in a location that will allow the records to be reasonably produced for examination within the time period required.

(2) Third-Party maintenance related responsibilities shall be set forth in a written agreement, a copy of which shall be maintained by the insurer and available for purposes of examination.

~~**Conflict of Interest**~~

~~A. If a member of a holding company system, a mortgage guaranty insurance company licensed to transact business in this state shall not, as a condition of its certificate of authority, knowingly underwrite mortgage guaranty insurance on mortgages originated by the holding company system or an affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly, by the holding company system or an affiliate.~~

~~A.~~ ~~B.~~ ~~A mortgage guaranty insurance company, the holding company system of which it is a part, or any affiliate shall not as a condition of the mortgage guaranty insurance company's certificate of authority, pay any commissions, remuneration, rebates or engage in activities proscribed in Sections 13 and 14.~~

~~**Section 16.**~~ ~~**Reserves**~~

~~A.~~ ~~Unearned Premium Reserves~~

~~A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve as set forth by regulation adopted by the commissioner of insurance.~~

~~B.~~ ~~Loss Reserve~~

~~A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves that accurately reflect loss frequency and loss severity and shall include components for claims reported and for claims incurred but not reported, including estimated losses on:~~

~~(1) Insured loans that have resulted in the conveyance of property that remains unsold;~~

~~(2) Insured loans in the process of foreclosure;~~

~~(3) Insured loans in default for four (4) months or for any lesser period that is defined as default for such purposes in the policy provisions; and~~

~~(4) Insured leases in default for four (4) months or for any lesser period that is defined as default for such purposes in policy provisions.~~

~~C.~~ ~~Contingency Reserve~~

~~Each mortgage guaranty insurance company shall establish a contingency reserve out of net premium remaining (gross premiums less premiums returned to policyholders net of reinsurance) after establishment of the unearned premium reserve. The mortgage guaranty insurance company shall contribute to the contingency reserve an amount equal to fifty percent (50%) of the remaining unearned premiums. Contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, except that withdrawals may be made by the company in any year in which the actual incurred losses exceed thirty-five percent (35%) of the corresponding earned premiums, and no releases shall be made without prior approval by the commissioner of insurance of the insurance company's state of domicile.~~

~~If the coverage provided in this Act exceeds the limitations set forth herein, the commissioner of insurance shall establish a rate formula factor that will produce a contingency reserve adequate for the added risk assumed. The face amount of an insured mortgage shall be computed before any reduction by the mortgage guaranty insurance company's election to limit its coverage to a portion of the entire indebtedness.~~

~~D. Reinsurance~~

~~Whenever a mortgage guaranty insurance company obtains reinsurance from an insurance company that is properly licensed to provide reinsurance or from an appropriate governmental agency, the mortgage guaranty insurer and the reinsurer shall establish and maintain the reserves required in this Act in appropriate proportions in relation to the risk retained by the original insurer and ceded to the assuming reinsurer so that the total reserves established shall not be less than the reserves required by this Act.~~

~~E. Miscellaneous~~

~~(1) Whenever the laws of any other jurisdiction in which a mortgage guaranty insurance company subject to the requirement of this Act is also licensed to transact mortgage guaranty insurance require a larger unearned premium reserve or contingency reserve in the aggregate than that set forth herein, the establishment of the larger unearned premium reserve or contingency reserve in the aggregate shall be deemed to be in compliance with this Act.~~

~~(2) Unearned premium reserves and contingency reserves shall be computed and maintained on risks insured after the effective date of this Act as required by Subsections A and C. Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.~~

Section ~~17~~21. Regulations

The commissioner shall have the authority to promulgate rules and regulations deemed necessary to effectively implement the requirements of this Act.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

1976 Proc. II 15, 17, 647, 686, 747-753 (adopted).
1979 Proc. I 44, 47-48, 49, 719, 968-969 (corrected).

Draft: 8/8/23

Group Capital Calculation (E) Working Group
Virtual Meeting
July 27, 2023

The Group Capital Calculation (E) Working Group of the Financial Condition (E) Committee met July 27, 2023. The following Working Group members participated: John Rehagen, Chair (MO); Susan Berry, Vice Chair (IL); William Arfanis (CT); Philip Barlow (DC); Ray Spudeck (FL); Kevin Clark (IA); Roy Eft (IN); John Turchi and Christopher Joyce (MA); Judy Weaver (MI); Ben Slutsker (MN); Lindsay Crawford and Anthony Quandt (NE); David Wolf (NJ); Dale Bruggeman (OH); Diana Sherman (PA); Trey Hancock (TN); Mike Arendall (TX); and Connie Duong (VA). Also participating was: Kim Hudson (CA).

1. Discussed the Comment Letter Received from the ACLI

Jennifer McAdam (American Council of Life Insurers—ACLI) presented the ACLI's comment letter regarding the group capital calculation (GCC) scalar methodology proposal. She said the ACLI fully supports this proposal, and it believes excess relative risk (ERR) scalars are the most appropriate methodology for the GCC, specifically because ERR scalars recognize differences in reserve methodologies across jurisdictions. They can also adjust to significant changes in jurisdictional solvency regimes. Many global insurers are already using the ERR methodology to allocate group capital. In adopting ERR scalars, the ACLI wants to be sure to design methodological solutions to limit volatility in GCC results and have resources available for maintaining and updating ERR scalar calculations going forward. Therefore, the ACLI and several of its members have agreed to engage a team of consultants to help the NAIC address these issues for selected life and health scalars. The project aims to be completed by the end of the year.

The ACLI will identify sources of data in each jurisdiction, including a list of insurers making up each industry average and solvency ratios for each insurer included in the average and the first point of regulatory intervention. The project will also result in a recommendation of methodological solutions to address changes to scalars over time, including the length of the historical data series needed to provide accurate scalar estimates with limited volatility over time and methodologies for adjusting scalars to account for significant changes in jurisdictional solvency regimes. For example, Bermuda is having a solvency regime change in 2023, and Japan is in 2025. Additionally, McAdam made another point that was not included in the ACLI's comment letter. She said ERR scalars would work for the aggregation method (AM). This is why it is so urgent that the NAIC approve the ERR scalars. The GCC is supposed to be the U.S. AM, and the AM probably needs them for the comparability assessment, which starts very soon. Because the ACLI wants the GCC to be the AM in the U.S., approving ERR scalars for the GCC will help keep the process parallel and moving forward. The ACLI has put a lot of time and effort into planning for this project, and it plans to expend significant resources to get this work accomplished, which will benefit its members and all U.S. insurers.

Martin Mair (MetLife), chair of the ACLI's GCC Working Group, presented a side-by-side suitability comparison of the ACLI's and UnitedHealth Group's (UHG's) proposals for scalars. There are seven points.

The first point is the breadth of the industry support behind these two alternative proposals. The ACLI's proposal is supported by a broad group of life insurance companies, as well as the life trade ACLI, while the UHG's proposal is supported by a single company. While both scalar methodologies were proposed as early as 2017, there has been considerable development over time in the ERR scalars as opposed to the UHG's scalars.

The second point is that between 2020 and 2021, the American Academy of Actuaries (Academy) did an exhaustive vetting of the major scalar types that were around at the time to debate whether they were legitimate and what the pros and cons of each approach were. The ERR scalars were included as one of the scalar methodologies vetted by the Academy. The UHG's relative total asset requirement (TAR) approach was not vetted by the Academy; therefore, it bypassed that review from the Academy.

The third point is that the relative TAR scalars have not been calculated in the GCC field testing, which would not have a history leading up to the adoption if the NAIC were to adopt this approach. In contrast, the ERR scalars have been included in the GCC field testing, and the companies have been generating those results for quite some time, and they have a relatively long history of what those calculations look like.

The fourth point is that the relative TAR methodology requires additional collection of reserve data by each jurisdiction, which can be quite onerous to do. The ACLI does not have that type of additional reporting requirement.

The fifth point is that the NAIC would need some support in terms of how to collect the data to make a transition from a placeholder scalar to a more sophisticated scalar. This is why the ACLI has arranged for a team of consultants to help with this transition, which includes Oliver Wyman, the company that did the original consulting work back in 2015. The UHG's proposal has no such support for the transition.

The sixth point is that the UHG's proposal prefers to maintain the placeholder scalars, to which there are two major drawbacks. It is almost universally known that it is wrong to convert overseas capital to a risk-based capital (RBC) equivalent on a one-for-one basis from a theoretical perspective. So, the first major drawback is that it is an inaccurate calculation to begin with. The other major drawback is that the proposal does not have a mechanism for adjusting for a jurisdictional regime change. At the end of the year, Bermuda is enacting a significant change in its solvency regime. A placeholder scalar will not adjust for it. So, volatility will be seen in the GCC figures based on changing ratios in Bermuda. At the end of 2025, Japan is going to be implementing a major regime change, moving from its current solvency margin ratio (SMR) basis to the insurance capital standard (ICS) solvency II basis. Mair said a very significant change in Japan's solvency ratios is expected to be seen. They are expected to change from 700% to 800% on average and eventually to around 300% post-2025, which is a major downward shift in ratios. A major drop in the GCC ratios will be seen using placeholder scalars for those companies that have operations in Japan. The ACLI's proposal for switching to the ERR adjusts for these changes, whereas the UHG's proposal does not. This is one of the selling points for getting funding from six companies in addition to the ACLI, particularly given the Bermuda change, which is happening at the end of the year. If the transition cannot be done by then, Mair is not sure whether that funding is going to be available in a future year to make it happen. So, it is now or never to make this scalar change.

The seventh point is that the ACLI's proposal of ERR scalars appropriately reflects the first point of regulatory intervention. The ERR scalars reflect the action of a prudent insurance company in multiple jurisdictions. A prudent insurer does not want to get to a point where they must submit a capital plan to a state insurance regulator and signal to the marketplace on the potential difficulty. ERR scalars use the first point of regulatory intervention as one of its primary benchmarks. Prudent insurers should try to stay out of that territory. The ERR scalars do not reflect the regulatory takeover but rather the first point of regulatory intervention. Therefore, the ACLI believes it aligns with what a prudent insurer would do in each major jurisdiction. Altogether, there are seven excellent reasons the ACLI believes its proposal is superior to the UHG's proposal.

In addition, Mariana Gomez-Vock (ACLI) provided some background. The ACLI has been highly engaged in every GCC exposure from 2017 to the present. It can attest that the process has robust stakeholder participation and opportunities to comment, particularly in 2020, when state insurance regulators met once a week to finalize the

GCC instructions, including the scalar methodology. There were at least 10 meetings of the ACLI's GCC Working Group during which scalar methodology was discussed. The Working Group settled on two final scalar options among multiple approaches. Initially, there were the pure relative ratio approach and the ERR approach. Both were included in the Academy's study, along with two other methods that the Academy proposed. The pure relative ratio approach is very similar to the ERR. The difference is how it treats available capital. Ultimately, the state insurance regulators decided that ERR was used as a placeholder for the sensitivity test of the GCC. Gomez-Vock said the Working Group and NAIC staff have three to four years' worth of data on the ERR. Lastly, she said she has a lot of respect for the state insurance regulators' commitment and the time they spent to really evaluate and consider views from all stakeholders with respect to the process.

Clark had a follow-up question related to a comment Mair made. He asked why it is now or never to decide on a methodology change. Mair said the NAIC needs some help from the industry in terms of making the transition. The ACLI and six volunteer companies agreed to provide the funding to make the transition happen. A major incentive for the companies to provide funding is that they do not want their own GCC figures to be volatile when there is a jurisdictional regime change. One of those regime changes coming up at the end of the year is in Bermuda. Therefore, companies want to have some type of mechanism to adjust for those changes. If the scalar methodology change does not happen this year, about one-third of the companies that provide funding are primarily involved in the Bermuda regime change and might fall off the list of providing funding. He is not sure whether the ACLI will be able to pull the funding together if this is not approved for this year.

Berry expressed her concerns regarding different methodologies between property/casualty (P/C), health, and life insurance companies. Gomez-Vock responded by pointing out that the ERR works for P/C and health insurance companies. She said the only reason these two lines of insurance companies were not included in the funding plan is that they did not have as much of a vested interest in participating. Scalars tend to be a much bigger deal for life insurers, which have long-term liabilities and liquid assets.

Rehagen asked how it would work in terms of ERR scalar percentages if the relative difference for health insurers is a lot different than the relative difference for life insurers. Gomez-Vock said it is designed to make the average operating ratios relative. Therefore, it is an average operating ratio for the life insurers, an average operating ratio for P/C insurers, and an average operating ratio for the health insurers. Mair agreed with what Gomez-Vock said. He said there will be different industry averages for each segment, and they may have different regulatory intervention rates as well. Each of them is going to vary by jurisdiction, but the methodology should be consistent.

Clark asked whether no comments on the exposure from the P/C trade should be taken as an agreement with the methodology and whether there are any past discussions that shed light on the level of consensus across the trades. Gomez-Vock said the ACLI aligned relatively closely with the American Property Casualty Insurance Association (APCIA) on the group capital type of issues. Based on her recent conversations with them, the scalar is not as big of a deal to them because they have short-term liabilities and assets.

Stephen Broadie (APCIA) said the APCIA does not disagree with the methodology. When it was presented to its members, they did not have a tremendous amount of interest in it. They are not opposed to the ERR methodology.

Rey Villarreal (Genworth) made a comment and expressed concern about the application, specifically. He said Genworth is a life and mortgage insurer. The lack of scaling applied to different lines of business to calibrate continues to be a concern. Genworth has brought it up in the past, and it pointed this out in its GCC filing.

Berry asked Broadie whether the P/C industry will be concerned with the ERR methodology at a later point. Broadie said they have looked at the ERR approach, and they do not have concerns with it.

Tom Finnell (America's Health Insurance Plans—AHIP) said he is going to ask AHIP's members with significant international business whether they can support the ERR proposal or not.

Gomez-Vock said current scalars are different for different lines of insurance companies. In addition, she said people have had many opportunities to object if they had serious concerns because companies with international business have already been calculating the scalar when completing the sensitivity test of the GCC.

James Braue (UHG) made a clarification on the last two points for their relative TAR approach, which was presented by Mair in the suitability comparison. He said this approach basically takes exactly what was done for the ERR approach and adds in the reserves. Therefore, there was no intention to use a different benchmark to speak for the capital, and it only reflects the reserves directly. Therefore, the last two points for the relative TAR approach should have been shown as "Yes" instead.

2. <u>Discussed the Comment Letter Received from the UHG</u>

Braue presented the UHG's comment letter, and he said the only theoretical assumption that it is making is the one that is stated to underlie the ERR, which is that insurers will tend to hold the same level of conservatism across all jurisdictions. Everything the UHG is doing from here out is just arithmetic. In addition, Braue pointed out a mistake in the arithmetic of the UHG's mathematical demonstration, which was used to show that the ERR approach can produce very incorrect results under certain circumstances. The UHG believes it is its responsibility to point out that the ERR approach has this mathematical flaw in it. Braue continued to point out that there is a relatively easy methodological fix to this problem, as the ACLI noted, that would require additional information about the different jurisdictions. He said he could not comment on how easy or difficult it would be to obtain that information. Based on the information the UHG has, it cannot say anything about how large this potential error is in any given jurisdiction. It is up to the Group Capital Calculation (E) Working Group to decide how much of a concern this potential for error is.

Mair made a comment and said the ERR methodology accounts for reserve differences across jurisdictions. MetLife does not believe there is a significant error in the calculation, which was not pointed out in the Academy's study. Mair said the ERR scalars are the best option for the current time, given all the vetting and calculations that have happened. Any better option can be adopted in the future.

Kevin Mackay (MetLife) said he does not believe the UHG's example works because it does not calculate the ERR properly. Braue said a company in any jurisdiction can deviate from the average, while the premise of the ERR approach is that the average company will maintain the same level of conservatism regardless of jurisdiction.

Rehagen asked Mair about the outlier identification. Mair explained how the ERR approach works. For example, if a company's solvency ratio in a jurisdiction is significantly above the average, which is considered an outlier, when the ratio gets mapped into the GCC, it will be above the average capital that is reflected in the GCC.

3. <u>Discussed the Scalar Methodology Proposal</u>

Berry said she has reservations about moving forward when the Working Group has not heard from health insurers. In addition, she is curious whether any of the P/C companies with a large amount of international business have any different thoughts on this.

Joyce said he agreed with Berry's concerns, but he wondered whether it will be easily resolved by giving the P/C and health industry a short window to provide any concerns. If they do not provide any concerns by then, the Working Group can consider moving forward with the proposal. In addition, he asked whether any of the NAIC staff have any concerns about the proposal. Ned Tyrrell (NAIC) asked whether the proposal, which was driven by life insurers, includes P/C and health insurers. Gomez-Vock said the Working Group could consider adopting it for the life industry at least and then give the health and P/C industry two additional weeks to inform the Working Group of their views. Tyrrell asked whether consultants could produce scalars for all industries or for the life industry only. Gomez-Vock said the ACLI could not bear the significantly incremental cost of producing scalars for the P/C and health industries.

Joseph B. Sieverling (Reinsurance Association of America—RAA) said there is no perfect way to estimate scalars. The ERR is the best approach based on the RAA's evaluation in 2019 and 2020.

Rehagen said he had some concerns that the procedure for updating should include all types of companies.

Weaver said she believes there was enough time for everybody to weigh in, and she was fine moving forward with the ACLI's proposal. Berry said she did not take issue with moving forward with life scalars and then developing P/C and health scalars later. She said she took issue with the possibility that there is a different methodology, which is her only concern. Clark said he had some concerns about how this might affect the scalar methodology for the AM. Barlow asked whether any information is expected to be received in the short term to help address this question. Tyrrell said the assessment is starting soon, but it is not going to be completed until late 2024.

4. Adopted the Scalar Methodology Proposal for Life Insurance Companies

Rehagen said it is important to get a methodology to maintain the scalar.

Weaver made a motion, seconded by Crawford, to move forward with the ACLI's proposal.

Bruggeman asked whether the ACLI's proposal is for all types of companies or just for life insurers. Weaver said she is willing to limit it to life insurers and then give P/C and health insurers two more weeks if this is the will of the Working Group.

Rehagen took a vote. All were in favor of adopting the ERR scalar proposal (Attachment Two-A) except for Berry. Berry was opposed to this motion because it leaves open the possibility for different methodologies. She said she would prefer to wait an additional two weeks to see if there are any methodology recommendations from the other two lines of insurance companies and then move forward altogether.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Committees/E CMTE/2023-2-Summer/GCCWG/GCC 07-27-23 Minutes.doc

Draft: 6/21/23

Group Capital Calculation (E) Working Group
Virtual Meeting
June 13, 2023

The Group Capital Calculation (E) Working Group of the Group Capital Calculation (E) Working Group met June 13, 2023. The following Working Group members participated: John Rehagen, Chair (MO); Susan Berry, Vice Chair (IL); Susan Bernard and Michelle Lo (CA); John Loughran (CT); Philip Barlow (DC); Ray Spudeck (FL); Roy Eft (IN); Kevin Clark (IA); John Turchi and Christopher Joyce (MA); Judy Weaver (MI); Ben Slutsker (MN); Lindsay Crawford and Anthony Quandt (NE); David Wolf (NJ); Bob Kasinow (NY); Dale Bruggeman and Tim Biler (OH); Doug Hartz (OR); Diana Sherman (PA); Trey Hancock (TN); Amy Garcia (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed the Proposed Scalar for the 2023 GCC

Rehagen announced that Susan Berry (IL) had agreed to serve as the Working Group's vice chair. He then provided background on the topic for the day. He said there were several conversations over the past year about moving forward with the scalar proposal and also discussions around making sure any scalar that is considered for adoption has a good process for updating, as well as not having the scalars move things around too much from one period to the next.

Martin Mair (MetLife), representing the American Council of Life Insurers (ACLI), presented the group capital calculation (GCC) scalar proposal for the 2023 GCC. He said that currently the GCC includes multiple scalar methodologies in the calculation and is set up with a placeholder scalar as the primary calculation, which is an unscaled approach, and all the other scalar methodologies are set up to be sensitivities within the calculation. The ACLI proposal is to adopt the excess relative ratio (ERR) approach as the primary scalar methodology, and all the other scalar methodologies will continue to be viewed as sensitivities to the primary approach. He said these scalar methodologies need to be maintained and updated as Rehagen mentioned and so always reflect current conditions without too much volatility into the system. He said different scalar approaches do not give dramatically different answers in terms of converting overseas capital ratios into a risk-based capital (RBC) ratio equivalent.

Mair pointed out some advantages of the ERR approach. The first one is that the scalar methodology best recognizes differences in required reserves across different jurisdictions. He used the Japanese solvency regime as an example, which sees a typical solvency ratio of 800% for a life insurance company compared to 400% in the U.S. He said the difference in reserving requirements accounts for most of the differences in the capital ratios across different jurisdictions. He said the Solvency II-like jurisdictions tend to have relatively low reserve requirements relative to the U.S., which is balanced by a higher required capital. As a result, solvency ratios generally end up lower. In addition, he said the second advantage is that the ERR approach preserves insurer excess capital and aligns with the prudent insurer solvency management.

Mair said this approach uses two benchmarks to establish the scalar. The first one is the average insurer solvency ratio in each jurisdiction because companies generally want to keep somewhere around the industry average to maintain competitiveness in the marketplace. The second one is the point of first regulatory intervention where there is a capital plan required of the insurer by the regulator. He said the capital level is managed to be around the industry average not only under normal circumstances, but also under a stress situation such as the great financial crisis or severe increases in the interest rates that the local operation in the jurisdiction can continue to operate without a regulatory intervention to maintain independence under stress. The ERR approach incorporates both of these elements as benchmarks. He said this is how many insurers manage their capital, and MetLife is one of them.

Rehagen asked whether this is for life insurance only. Mair said this proposal is going to cover both life and health insurance. He said this approach should be the primary approach for all insurance companies, and the ACLI thinks this is the best approach across different lines.

Mair continued to explain why it is important to make this change now. He said the consistency in the solvency regime around the world is about to change, and there will be significant changes to the solvency regime in the next few years. Bermuda is going to make some significant changes to its solvency regime at the end of the year, which is expected to have a significant change to its ratios. Additionally, Japan is expected to adopt the insurance capital standard (ICS) at the end of 2025. The current placeholder scalars are unresponsive to these changes, which would cause significant volatilities in the GCC ratio, and this is caused by nothing other than a regulatory regime change. He said the reason to set up a responsive scalar mechanism/methodology is to get prepared for regulatory regime changes and to be able to make proper adjustments to the scalar so that the GCC ratio remains relatively stable.

In addition, Mair talked about how to support this approach and make the change robust over time. He said last time the ACLI took a deeper dive into this was in 2015 and 2016. There is a need for ongoing work both from identifying data sources for the average solvency ratio in 14 jurisdictions and what the point of first regulatory intervention is in each jurisdiction, as well as a number of outstanding methodological issues such as representative insurers and their jurisdictions. So, a consultant will work through these with the industry and the NAIC. The ACLI put out bids for this work and has identified a dream team of consultants to work on this project. One of them is Oliver Wyman, which did in-depth work back in 2015 and 2016, and it has agreed to work on this project to support the transition. The other one is Lou Felice, who was with the NAIC in 2015 and was a central figure in pulling this together with health scalars as one of his specialties. The total cost is estimated to be $300,000 for 2023. The ACLI and six individual insurers have agreed to share the cost. It is up to the Working Group to decide whether all these are acceptable. He said if acceptable, they will start to engage the consultants and work on the project. He said they hope to have 2023 year-end data for the GCC be based on the scalar methodology.

Tom Finnell (America's Health Insurance Plans—AHIP) asked whether the proposed scalars are for life and health business combined or are separate scalars for the health business. Mair said the ACLI is thinking of separate health scalars for selected jurisdictions, and Japan is one of them.

Rehagen asked Mair whether he had any reaction to the June 1 meeting of the Federal Reserve Board's (FRB's) Insurance Policy Advisory Council (IPAC), which is a group of volunteers in the industry advising on insurance matters. During the meeting, the group provided an update to its project on scalars, which is going to be combined into a paper later this summer. Mair said the ACLI had discussions with the FRB on whether there would be any issue if the NAIC adopts the ERR approach in light of the IPAC scalar review, and the answer they received was that there is no perceived conflict between the two. IPAC's scalar review is an educational tool. Because the ICS methodology does not include anything like scalars and everything is based on a mark-to-market basis, there is no need to convert from one jurisdiction to another since they are all treated equally. The FRB did not feel that the selection of one scalar methodology over another would have any impact on the comparability assessment.

Rehagen said he is interested in seeing if there is any inconsistency between what they come up with and the NAIC approach. Mair said the answer he got was that this would neither improve the chances for comparability nor degrade the chances for favorable comparability assessments.

Rehagen asked whether any Working Group members, other insurance regulators, and interested parties have any questions. Ned Tyrrell (NAIC) asked about where the data is coming from and the scope of the data. He wondered whether there are any jurisdictions where it would be as easy to get scalars for property/casualty (P/C) insurance without too much extra effort beyond what would be needed to get the life or health scalars.

Mair said the industry and consultants would work together and make recommendations to the NAIC. He said it is up to the NAIC to be comfortable with and approve them. He said the focus of this project is to find the data and develop those methodologies for the life and selected health jurisdictions. He said he does not know the answer to Tyrrell's question. However, he speculated that it may be easier for P/C once data sources are identified for the other sectors. Tyrrell said various online databases are available for free for European P/C insurance companies and Canadian companies. Mair said Lou Felice might be able to help identify the data sources not only for life and health, but also for P/C along the way.

Quandt asked whether it would be more lenient than risk-based capital (RBC) if insurers move their risks to a jurisdiction with lighter reserve requirements to release capital. Mair said there is a rough equivalence across the major jurisdictions in terms of the overall level of conservatism in the combination of the reserves, capital requirements, and capital ratios. In the major jurisdictions, there are a lot of entities that operate across different jurisdictions, which run to relatively similar levels of conservatism overall even though their capital ratios look different. Tyrrell asked whether a similar level of conservatism would be RBC at 200% or 300%. Mair said RBC at 200%. Tyrrell asked what the equivalent for a European entity would be. Mair said it would typically be about 250% for life, which is a similar level of conservatism on a holistic basis of reserves, capital, and capital ratio.

Without further questions, the Working Group agreed to expose the GCC scalar proposal for a 30-day public comment period ending July 13.

Having no further business, the Group Capital Calculation (E) Working Group adjourned.

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ACLI GCC Scalar Proposal

June 2023

ACLI Proposal and Projected Support

The primary GCC calculation currently relies on placeholder scalars, which convert non-US available and required capital figures into an RBC equivalent on a 1:1 basis. Other scalar methodologies are reported on a sensitivity basis.

ACLI has pointed out significant shortcomings of placeholder scalars and has proposed that Excess Relative Ratio (ERR) scalars would generate superior GCC figures for regulators and industry.

ACLI has solicited consultant bids to facilitate a potential transition from placeholder scalars to ERR scalars during 2023 for the Life and Health sectors. This project has two major components:

1. Identify data sources for solvency ratios and regulatory intervention levels by jurisdiction
2. Work with NAIC to develop appropriate methodologies for generating ERR scalars over time (use of moving averages, dealing with jurisdictional solvency regime change, identifying representative insurers, etc.)

ACLI and six individual insurers have agreed to fund the total $300,000 consultant cost to engage Oliver Wyman and Lou Felice to help NAIC transition to ERR scalars during 2023.

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Executive Summary

Replacing placeholder scalars with ERR will appropriately recognize non-U.S. business in the GCC formula

Credible approaches – Prob. of Negative Outcomes (PNO), Pure & Excess Ratio - produce directionally similar scalars

Excess Ratio approach has two critical advantages relative to other ratio-based approaches:
1. Excess Ratio best recognizes ***cross-jurisdictional differences in required reserves***
2. Excess Ratio best reflects ***capital management practices of prudent global insurers***

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ERR Scalar Benefits for US Insurers

Replacing placeholder scalars with ERR scalars provides multiple benefits for US insurers:

1. Unlike placeholder scalars, ERR scalars can be designed to adjust immediately to solvency regime changes, avoiding uneconomic GCC volatility through time
2. Since ERR scalars recognize cross-jurisdictional differences in required reserves, ERR scalars produce GCC figures most accurately aligned with RBC – facilitating insurers' most efficient allocation of capital
3. By helping select representative insurers in each jurisdiction, industry can improve the accuracy of each jurisdictional scalar
4. By providing input into scalar update methodologies, insurers can align future GCC figures with their internal forecasts
5. ERR scalars can also be leveraged for IAIS comparability purposes – to convert GCC into ICS-equivalent figures

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Improving GCC Accuracy

Replacing the existing approach with ERR scalars will improve GCC accuracy and avoid the following potential criticisms of current placeholder:
- No justification for assuming available & required capital is equivalent globally
- Placeholder scalar penalizes insurers in the many jurisdictions with Solvency II-like regimes

Credible scalars are ***directionally consistent*** converting overseas capital to RBC
- ➢ Japan SMR is discounted heavily when converted to RBC equivalent
- ➢ Conversely, Solvency II-like ratios are increased upon conversion to RBC

Different scalar approaches use similar underlying data (regulatory intervention points, industry average ratios) across risk-sensitive jurisdictions, resulting in roughly similar scalar estimates

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Unique Advantages of Excess Ratio Approach

Excess Ratio methodology best recognizes differences in required reserves across jurisdictions
- ➢ JGAAP reserves are very stringent, balanced by lower required capital
- ➢ Jurisdictions with Solvency II-like regimes often have relatively low reserve requirements, balanced by higher required capital

Excess Ratio preserves insurers' excess capital and aligns with prudent insurers' solvency management:

1. Ongoing Competitiveness: Manage local solvency ratio within range of industry average to ensure ability to sell new products

2. Independence Under Stress: Manage local solvency to remain independent of regulatory intervention during the inevitable periods of market stress

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Appendix 1: Excess Ratio Scalars in GCC Template

	Life	Non-Life	Health
Canada	15%	28%	
Bermuda	44%	44%	
Japan	101%	121%	72%
Solvency II (EU)	31%	47%	
Solvency II (UK)	31%	47%	
Australia	30%	30%	30%
Switzerland	16%	56%	
Hong Kong	100%	100%	
Singapore	100%	100%	100%
Chinese Taipei	100%	100%	100%
South Africa	100%	100%	100%
Mexico	100%	100%	
China	100%	100%	
South Korea	100%	100%	

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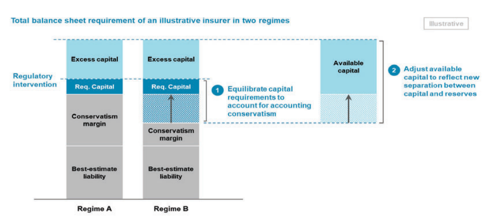
Appendix 2: How does the Excess Relative Ratio Adjust for Key Differences?

The Excess Relative Ratio scalar is a total balance sheet-based approach that recognizes different accounting conservatism levels to equilibrate capital requirements:



1. Also accounts for differences in asset valuation and admissibility rules (e.g., for intangible assets). For instance, assets admitted under Regime B but not Regime A may be considered a "contra-liability" in Regime B that is subsequently removed when raising Regime B's conservatism margin to equilibrate Regime B and Regime A.

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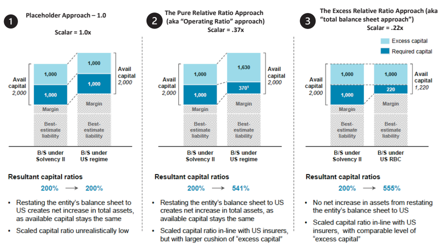
Appendix 3: Distinguishing Between Alternative Scalar Approaches



1. Scalar = 100% SII SCR / 100% RBC CAL (applied to required capital)
2. Scalar = 191% SII SCR / 518% RBC CAL (applied to required capital)
3. See previous slide for scalar calibration and application details

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Appendix 4: Sample Demonstration of Excess Scalar

A US-based life insurer has significant operations in both Europe (Solvency II) and Japan.
In each jurisdiction, the insurer has an industry-average solvency ratio.

How are excess scalars developed, and what is the insurer's GCC ratio?

	Assumptions	US	SII	Japan
(a)	Industry Avg Ratio (%)	400%	200%	800%
(b)	First Regulatory Intervention (%)	100%	100%	200%
(c)	Current Available Capital ($)	$400	$200	$400
(d)	Available Capital at Intervention ($)	$100	$100	$100
(e)	Required Capital ($)	$100	$100	$50
$\frac{(a)-(b)}{(b)}$ = (f)	Excess Ratio	**300%**	**100%**	**300%**
$\frac{(f)\ Country}{(f)\ US}$ = (g)	Excess Scalar[1]	**N/A**	**0.333**	**1.00**

[1]Actual excess scalars listed on GCC Template (slide 6) are **0.31 (SII)** and **1.01 (Japan)**

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Appendix 5: Applying Excess Scalars to SII and Japan

ountry scaled capital example

xcess scalars are first applied to required capital

		SII	Japan
)	Available Capital at Intervention	$100	$100
)	Scalar	0.333	1.00
) X (b) = (c)	Scaled Required Capital	$33	$100
) – (a) = (d)	Required Capital Difference	($67)	$0

vailable Capital is adjusted by the change in required capital

		SII	Japan
)	Current Available Capital	$200	$400
)	Required Capital Difference	($67)	$0
) – (d)	Scaled Available Capital	$133	$400

Group capital aggregation example

	US	SII	Japan	GROUP
Scaled Available Capital	$400	$133	$400	$933
Scaled Required Capital	$100	$33	$100	$233
Solvency Ratio	*400%*	*400%*	*400%*	*400%*

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Appendix 6: Sample Methodological Issues in Generating Scalars

A robust framework for generating scalars should address issues including:

1. How long of an historical time series is required (e.g., 5-year rolling average)?
2. What minimum percentage of the industry should be included in the average?
3. What circumstances justify excluding certain companies from the calculation (e.g., outlier ratios or ratings, very different business model, not representative of IAIG's)?
4. How should jurisdictional scalars adjust when there is a regulatory regime change?
5. Should there be a minimum trigger for year-over-year changes in scalars? Excluding a change in solvency regime, should scalars generally be static for a period of time and revised every few years?
6. What outcomes suggest that a particular scalar is not appropriate?

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Date: 8/11/23

Mortgage Guaranty Insurance (E) Working Group
Virtual Meeting
July 13, 2023

The Mortgage Guaranty Insurance (E) Working Group of the Financial Condition (E) Committee met July 13, 2023. The following Working Group members participated: Jackie Obusek, Chair (NC); Kurt Regner (AZ); Monica Macaluso (CA); Bradley Trim (FL); John Rehagen (MO); Margot Small (NY); Diana Sherman (PA); Chris Miller (TX); and Amy Malm and Levi Olson (WI).

1. Adopted its Spring National Meeting Minutes

Rehagen made a motion, seconded by Macaluso, to adopt the Working Group's March 22 minutes (*see NAIC Proceedings – Spring 2023, Financial Condition (E) Committee*, *Attachment One*). The motion passed unanimously.

2. Adopted Amendments to Model #630

Obusek commented that during the Spring National Meeting, the Working Group discussed draft revisions to the *Mortgage Guaranty Insurance Model Act* (#630) (Attachment Three-A). Following this discussion, the drafting group met and integrated revisions to the draft and re-exposed Model #630 for a 15-day public comment period that ended May 26. As a result of the exposure, a letter was received from the Center for Economic Justice (CEJ) and the mortgage guaranty consortium (MGC) (Attachment Three-B). Obusek asked to hear from those who submitted comments.

Birny Birnbaum (CEJ) indicated that the CEJ requested three changes to the draft revised model. The first change is that Section 21—No Private Right of Action be stricken and replaced with an explicit private right of action for violations of those provisions of the model for which consumer harm can be directly demonstrated and which avoid any provision that interferes with solvency regulation. Birnbaum noted that there is no other personal lines model law that has a provision barring a private right of action, and the inclusion in the model law would be unprecedented. He further commented that a private right of action is warranted based on the history of private mortgage insurers' actions leading up to the 2008 financial crisis. He said the proposed ban on private litigation is unfair by limiting consumer access to courts while leaving insurers free to sue consumers.

Birnbaum indicated that the next two amendment requests relate to Section 18A—Inducements and Section 18C—Rebates. He proposed that both be stricken, as they water down critical consumer protections by allowing room for insurers to engage in anti-competitive and unsound business practices. He stated that the recent revisions to the *Unfair Trade Practices Act* (#880) focus on a declaration that insurer risk mitigation efforts are not illegal rebates; however, there is no loss mitigation associated with an inducement. He reasoned that Section 18C should be removed because there is no way for a rebate, as set out in the proposed model, to comply with the remaining portion of the paragraph because if the rebate is set forth in the filed rates, it is not a rebate but a rate discount. He further indicated that referencing Model #880 is inapplicable because rebates are not policy form provisions approved by the state insurance regulator.

Birnbaum stated that the MGC requested the deletion of the anti-deficiency judgment protection in Section 14A—Policy Forms, and the CEJ opposed the change and urged retention of the anti-deficiency protection for several reasons: 1) permitting deficiency judgments penalizes consumers who are victims of economic conditions that depress home prices; 2) deficiency collection is often limited; and 3) the CEJ found no anomaly in prohibiting a mortgage insurer from pursuing a deficiency judgment while permitting a lender to do so. Therefore, the industry proposal would potentially subject a consumer to two deficiency lawsuits for the same deficiency.

Benjamin Schmidt (Radian Guaranty Inc.) commented on behalf of the MGC. He stated that Radian Guaranty Inc.'s comment letter included the same stance that the MGC had already provided regarding Section 10B(1). He stated that the language in the exposure would discourage the use of reinsurance, as reinsurers may not file statutory financial statements and in those instances would not have a way to report contingency reserves. He indicated that the suggested language from the MGC would clarify that the Contingency Reserve requirement is achieved based on the maintenance by the reinsurer of equivalent collateralized or segregated assets supporting the reinsurance obligations even if the reinsurer does not file a statutory financial statement. He also commented on Section 14A, stating that the second sentence should be removed entirely based on the comments from the MGC's prior letter. He indicated that the sentence was partially deleted following its November 2022 comment letter; however, it may have inadvertently been restored to the current draft after the MGC flagged a fragment of the sentence that remained in the February exposure draft.

Obusek indicated that the comments heard were not new topics, and they have already been discussed. She stated that after materials for the meeting were posted, there was additional communication with the CEJ on the issues raised in its comment letter. As a result of those discussions, she proposed an amendment to Section 18A and Section 18C to remove the first sentence and Section 21 entirely from the model.

Hearing no further discussion, Malm made a motion, seconded by Rehagen, to adopt the proposed amendments to Model #630 with an amendment to Section 18A and Section 18C to strike, "Unless set forth in the policy and subject to the [state equivalent of the Unfair Trade Practices Act #880]" and strike in its entirety Section 21. The motion passed with New York opposing.

Having no further business, the Mortgage Guaranty Insurance (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/MGIWG/2023 Summer NM/MGIWG Open Mtg Minutes July 13 2023.docx

Draft: [May 11, 2023]
Adopted by Mortgage Guaranty Insurance (E) Working Group—[insert date]
Adopted by [insert parent committee]—[insert date]

MORTGAGE GUARANTY INSURANCE MODEL ACT

Table of Contents

Section 1. Title

This Act may be cited as the Mortgage Guaranty Insurance Act.

Section 2. Definitions

The definitions set forth in this Act shall govern the construction of the terms used in this Act but shall not affect any other provisions of the code.

A. ~~A.~~ "Authorized ~~real estate security," for the purpose of this Act,~~Real Estate Security" means ~~an~~:

(1) An amortized note, bond or other ~~evidence~~instrument of indebtedness, except for reverse mortgage loans made pursuant to [insert citation of state law that authorizes reverse mortgages] of the real property law, evidencing a loan, not exceeding ~~ninety-five~~one hundred three percent (~~95~~103%) of the fair market value of the real estate, secured by a mortgage, deed of trust, or other instrument that constitutes, or is equivalent to, a first lien or ~~charge on real estate~~junior lien or charge on real estate, with any percentage in excess of one hundred percent (100%) being used to finance the fees and closing costs on such indebtedness; provided:

(a) ~~(1)~~ The real estate loan secured in this manner is one of a type that a ~~bank, savings and loan association, or an insurance company~~creditor, which is supervised and regulated by a department of ~~this~~any state or territory of the U.S or an agency of the federal government, is authorized to make, or would be authorized to make, disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate;

(~~2~~b) The ~~improvement on~~loan is to finance the acquisition, initial construction or refinancing of real estate that is a:

(i) Residential building designed for occupancy by not more than four families, a one-family residential condominium or unit in a planned unit development, or any other one-family residential unit as to which title may be conveyed freely; or

(ii) Mixed-use building with only one non-residential use and one one-family dwelling unit; or

(iii) Building or buildings designed for occupancy ~~as specified by Subsections A(1) and A(2) of this section; and~~by five (5) or more families or designed to be occupied for industrial or commercial purposes.

(~~3~~c) The lien on the real estate may be subject to and subordinate to ~~the following:~~

~~(a) The lien of any public bond, assessment or tax, when no installment, call or payment of or under the bond, assessment or tax is delinquent; and~~

~~(b) Outstanding mineral, oil, water or timber~~other liens, leases, rights, ~~rights-of-way, easements or rights-of-way of support, sewer rights, building~~ restrictions ~~or other restrictions or~~, easements, covenants, conditions or regulations of use~~, or outstanding leases upon the real property under which rents or profits are reserved to the owner thereof~~ that do not impair the use of the real estate for its intended purpose.

(2) Notwithstanding the foregoing, a loan referenced in Section 2A(1) of this Act may exceed 103% of the fair market value of the real estate in the event that the mortgage guaranty insurance company has approved for loss mitigation purposes a request to refinance a loan that constitutes an existing risk in force for the company.

(3) An amortized note, bond or other instrument of indebtedness evidencing a loan secured by an ownership interest in, and a proprietary lease from, a corporation or partnership formed for the purpose of the cooperative ownership of real estate and at the time the loan does not exceed one hundred three percent (103%) of the fair market value of the ownership interest and proprietary lease, if the loan is one of a type that meets the requirements of Section 2A(1)(a), unless the context clearly requires otherwise, any reference to a mortgagor shall include an owner of such an ownership interest as described in this paragraph and any reference to a lien or mortgage shall include the security interest held by a lender in such an ownership interest.

B. "Bulk Mortgage Guaranty Insurance" means mortgage guaranty insurance that provides coverage under a single transaction on each mortgage loan included in a defined portfolio of loans that have already been originated.

C. "Certificate of Insurance" means a document issued by a mortgage guaranty insurance company to the initial insured to evidence that it has insured a particular authorized real estate security under a master policy, identifying the terms, conditions and representations, in addition to those contained in the master policy and endorsements, applicable to such coverage.

D. ~~"Commissioner" means [insert the title of the principal insurance supervisory official] of this state, or the [insert the title of the principal insurance supervisory official]'s deputies or assistants, or any employee of the [insert name of the principal insurance regulatory agency] of this state acting in the [insert the title of the principal insurance supervisory official]'s name and by the [insert the title of the principal insurance supervisory official]'s delegated authority.~~"Commissioner." The term "commissioner" shall mean the insurance commissioner, the commissioner's deputies, or the Insurance Department, as appropriate.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the word "commissioner" appears.

E. ~~B.~~ ~~"Contingency reserve"~~"Contingency Reserve" means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.

~~C. "Mortgage guaranty insurance" is~~F. "Domiciliary Commissioner" means the principal insurance supervisory official of the jurisdiction in which a mortgage guaranty insurance company is domiciled~~, or that principal insurance supervisory official's deputies or assistants, or any employee of the regulatory agency of which that principal insurance supervisory official is the head acting in that principal insurance supervisory official's name and by that principal insurance supervisory official's delegated authority~~.

G. "Effective Guaranty" refers to the assumed backing of existing or future holders of securities by virtue of their issuer's conservatorship or perceived access to credit from the U.S. Treasury, as opposed to the direct full faith and credit guarantee provided by the U.S. government.

H. "Loss" refers to losses and loss adjustment expenses.

I. "Master Policy" means a document issued by a mortgage guaranty insurance company that establishes the terms and conditions of mortgage guaranty insurance coverage provided thereunder, including any endorsements thereto.

J. "Mortgage Guaranty ~~:~~

~~(1)~~ Insurance" is insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any ~~note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, provided the improvement on the real estate is a residential building or a condominium unit or buildings designed for occupancy by not more than four families;~~authorized real estate security.

~~(2) Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, providing the improvement on the real estate is a building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes; and~~

~~(3) Insurance against financial loss by reason of nonpayment of rent or other sums agreed to be paid under the terms of a written lease for the possession, use or occupancy of real estate, provided the improvement on the real estate is a building or buildings designed to be occupied for industrial or commercial purposes.~~

K. "Mortgage Guaranty Quality Assurance Program" means an early detection warning system for potential underwriting compliance issues which could potentially impact solvency or operational risk within a mortgage guaranty insurance company.

L. "NAIC" means the National Association of Insurance Commissioners.

M. "Pool Mortgage Guaranty Insurance" means mortgage guaranty insurance that provides coverage under a single transaction or a defined series of transactions on a defined portfolio of loans for losses up to an aggregate limit.

N. "Right of Rescission" represents a remedy available to a mortgage guaranty insurance company to void a certificate and restore parties to their original position, based on inaccurate, incomplete or misleading information provided to, or information omitted or concealed from, the mortgage guaranty insurance company in connection with the insurance application, resulting in an insured loan that did not meet the mortgage guaranty insurance company's eligibility requirements in effect on the date of submission of the insurance application.

O. "Risk in Force" means the mortgage guaranty insurance coverage percentage applied to the unpaid principal balance.

Section 3. Insurer's Authority to Transact Business

A company may not transact the business of mortgage guaranty insurance until it has obtained a certificate of authority from the commissioner.

Section 4. Mortgage Guaranty Insurance as Monoline

A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.

Section 5. Risk Concentration

A mortgage guaranty insurance company shall not expose itself to any loss on any one authorized real estate security risk in an amount exceeding ten percent (10%) of its surplus to policyholders. Any risk or portion of risk which has been reinsured shall be deducted in determining the limitation of risk.

Section 6. Capital and Surplus

A. **Initial and Minimum Capital and Surplus Requirements.** A mortgage guaranty insurance company shall not transact the business of mortgage guaranty insurance unless, if a stock insurance company, it has paid-in capital of at least $~~1~~10,000,000 and paid-in surplus of at least $~~1~~15,000,000, or if a mutual insurance company, a minimum initial surplus of $~~2~~25,000,000. A stock insurance company or a mutual insurance company shall at all times thereafter maintain a minimum policyholders' surplus of at least $~~1,500~~20,000,000.

~~**Section 4. Insurer's Authority to Transact Business**~~

~~No mortgage guaranty insurance company may issue policies until it has obtained from the commissioner of insurance a certificate setting forth that fact and authorizing it to issue policies.~~

B. ~~**Section 5.**~~ **Minimum Capital Requirements Applicability.** A mortgage guaranty insurance company formed prior to the passage of this Act may maintain the amount of capital and surplus or minimum policyholders' surplus previously required by statute or administrative order for a period not to exceed twelve months following the effective date of the adoption of this Act.

C. **Minimum Capital Requirements Adjustments.** The domiciliary commissioner may by order reduce the minimum amount of capital and surplus or minimum policyholders' surplus required under Section 6A under the following circumstances:

(1) For an affiliated reinsurer that is a mortgage guaranty insurance company and that is or will be engaged solely in the assumption of risks from affiliated mortgage guaranty insurance companies, provided that the affiliated reinsurer is in run-off and, in the domiciliary commissioner's opinion, the business plan and other relevant circumstances of the affiliated reinsurer justify the proposed reduction in requirements.

(2) For mortgage guaranty insurance companies that are in run-off and not writing new business that is justified in a business plan, in the domiciliary commissioner's opinion.

Section 7. Geographic Concentration

A. A mortgage guaranty insurance company shall not insure loans secured by a single risk in excess of ten percent (10%) of the company's aggregate capital, surplus and contingency reserve.

B. No mortgage guaranty insurance company shall have more than twenty percent (20%) of its total insurance in force in any one Standard Metropolitan Statistical Area (SMSA), as defined by the ~~United States~~U.S Department of Commerce.

C. The provisions of this section shall not apply to a mortgage guaranty insurance company until it has possessed a certificate of authority in this state for three (3) years.

Section ~~6~~8. Advertising

No mortgage guaranty insurance company or an agent or representative of a mortgage guaranty insurance company shall prepare or distribute or assist in preparing or distributing any ~~brochure, pamphlet, report or any form of~~ advertising media or communication to the effect that the real estate investments of any financial institution are "insured investments," unless the ~~brochure, pamphlet, report or~~ advertising media or communication clearly states that the loans are insured by mortgage guaranty insurance companies possessing a certificate of authority to transact mortgage guaranty insurance in this state or are insured by an agency of the federal government~~, as the case may be~~.

Section ~~7~~9. Investment Limitation

~~A mortgage guaranty insurance company shall not invest~~Investments in notes or other evidence~~s~~ of indebtedness secured by a mortgage or other liens upon residential real property shall not be allowed as assets in any determination of the financial condition of a mortgage guaranty insurer. This section shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contract~~s~~ of sale are acquired in the course of ~~the~~ good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property so acquired. This section shall not apply to investments backed by the full faith and credit of the U.S. Government or investments with the effective guaranty of the U.S. Government. This section shall not apply to investments held by a mortgage guaranty insurance company prior to the passage of this Act.

Section ~~8. Coverage Limitation~~10. Reserve Requirements

A. **Unearned premium Reserves, Loss Reserves, and Premium Deficiency Reserves.** Financial reporting will be prepared in accordance with the Accounting Practices and Procedures Manual and Annual Financial Statement Instructions of the NAIC.

B. **Contingency Reserve.** Each mortgage guaranty insurance company shall establish a contingency reserve subject to the following provisions:

(1) The mortgage guaranty insurance company shall make an annual contribution to the contingency reserve which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.

(2) Except as provided within this Act, a mortgage guaranty insurance company's contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, to provide for reserve buildup. The portion of the contingency reserve established and maintained for more than 120 months shall be released and shall no longer constitute part of the contingency reserve.

(3) Withdrawals may be made from the contingency reserve on a first-in, first-out basis or such other basis, with the prior written approval of the domiciliary commissioner, based on the amount by which:

(a) Incurred losses and loss adjustment expenses exceed 35% of the direct earned premium in any year. Provisional withdrawals may be made from the contingency reserve on a quarterly basis in an amount not to exceed 75% of the withdrawal as adjusted for the quarterly nature of the withdrawal; or

(b) Upon the approval of the domiciliary commissioner and 30-day prior notification to non-domiciliary commissioners, a mortgage guaranty insurer may withdraw from the contingency reserve any amounts which are in excess of the requirements of Section 15 as required in [insert section of the mortgage guaranty Insurance model law requiring minimum policyholder's position] as filed with the most recently filed annual statement.

(i) The mortgage guaranty insurance company's domiciliary commissioner may consider loss developments and trends in reviewing a request for withdrawal. If any portion of the contingency reserve for which withdrawal is requested is maintained by a reinsurer or in a segregated account or trust of a reinsurer, the domiciliary commissioner may also consider the financial condition of the reinsurer.

C. **Miscellaneous.** Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.

Section 11. Reinsurance

A. **Prohibition of Captive Reinsurance.** A mortgage guaranty insurance company shall not enter into captive reinsurance arrangements which involve the direct or indirect ceding of any portion of its insurance risks or obligations to a reinsurer owned or controlled by an insured; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity owned or controlled by an insured or an insured's officer, director or employee or any member of their immediate family that has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing.

B. **Reinsurance Cessions.** A mortgage guaranty insurer may, by written contract, reinsure any insurance that it transacts, except that no mortgage guaranty insurer may enter into reinsurance arrangements designed to circumvent the compensating control provisions of Section 17 or the contingency reserve requirement of Section 10. The unearned premium reserve and the loss reserves required by Section 10 shall be established and maintained by the direct insurer or by the assuming reinsurer so that the aggregate reserves shall be equal to or greater than the reserves required by direct writer. The cession shall be accounted for as provided in the accounting practices and procedures prescribed or permitted by the applicable Accounting Practices and Procedures Manual of the NAIC.

Section 12. Sound Underwriting Practices

A. **Underwriting Review and Approval Required.** All certificates of mortgage guaranty insurance, excluding policies of reinsurance, shall be written based on an assessment of evidence that prudent underwriting standards have been met by the originator of the mortgage. Delegated underwriting decisions shall be reviewed based on a reasonable method of sampling of post-closing loan documentation to ensure compliance with the mortgage guaranty insurance company's underwriting standards.

B. **Quality Control Reviews.** Quality control reviews for bulk mortgage guaranty insurance and pool mortgage guaranty insurance shall be based on a reasonable method of sampling of post-closing loan documentation for delegated underwriting decisions to ensure compliance with the representations and warranties of the creditors or creditors originating the loans and with the mortgage guaranty insurance company's underwriting standards.

C. **Minimum Underwriting Standards.** Mortgage guaranty insurance companies shall establish formal underwriting standards which set forth the basis for concluding that prudent underwriting standards have been met.

D. **Underwriting Review and Approval.** A mortgage guaranty insurance company's underwriting standards shall be:

(1) ~~A mortgage guaranty insurance company shall limit its coverage net of reinsurance ceded to a reinsurer in which the company has no interest to a maximum of twenty-five percent (25%) of the entire indebtedness to the insured or in lieu thereof, a mortgage guaranty insurance company may elect to pay the entire indebtedness to the insured and acquire title to the authorized real estate security.~~

~~**Section 9.**~~ Reviewed and approved by executive management, including, but not limited to the highest-ranking executive officer and financial officer; and

(2) Communicated across the organization to promote consistent business practices with respect to underwriting.

E. **Notification of Changes in Underwriting Standards.** On or before March 1 of each year, a mortgage guaranty insurance company shall file with the domiciliary commissioner changes to its underwriting standards and an analysis of the changes implemented during the course of the immediately preceding year. The annual summary of material underwriting standards changes should include any change associated with loan to value ratios, debt to income ratios, borrower credit standing or maximum loan amount which has resulted in a material impact on net premium written of +/- 5% from prior year to date.

Nondiscrimination. In extending or issuing mortgage guaranty insurance, a mortgage guaranty insurance company

~~A. A mortgage guaranty insurance company that anywhere transacts any class of insurance other than mortgage guaranty insurance is not eligible for the issuance of a certificate of authority to transact mortgage guaranty insurance in this state nor for the renewal thereof.~~

~~B. A mortgage guaranty insurance that anywhere transacts the classes of insurance defined in Section 2A(2) or 2A(3) is not eligible for a certificate of authority to transact in this state the class of mortgage guaranty insurance defined in Section 2A(1). However, a mortgage guarantee insurance company that transacts a class of insurance defined in Section 2A may write up to five percent (5%) of its insurance in force on residential property designed for occupancy by five (5) or more families.~~

~~**Section 10. Underwriting Discrimination**~~

~~A. Nothing in this chapter shall be construed as limiting the right of a mortgage guaranty insurance company to impose reasonable requirements upon the lender with regard to the terms of a note or bond or other evidence of indebtedness secured by a mortgage or deed of trust, such as requiring a stipulated down payment by the borrower~~may not ~~.~~

F. ~~B. No mortgage guaranty insurance company may~~ discriminate ~~in the issuance or extension of mortgage guaranty insurance on the~~ on the basis of the applicant's sex, marital status, race, color, creed ~~or national origin~~, national origin, disability, or age or solely on the basis of the geographic location of the property to be insured unless the discrimination related to geographic location is for a business purpose that is not a mere pretext for unfair discrimination; or the refusal, cancellation, or limitation of the insurance is required by law or regulatory mandate.

~~C. No policy~~**Drafting Note**: States and jurisdictions should consult their constitution or comparable governance documents and applicable civil rights legislation to determine if broader protections against unacceptable forms of discrimination should be included in Section 12F.

Section 13. ~~mortgage guaranty insurance~~**Quality Assurance**

A. **Quality Assurance Program.** A mortgage guaranty insurance company shall establish a formal internal mortgage guaranty quality assurance program, which provides an early detection warning system as it relates to potential underwriting compliance issues which could potentially impact solvency or operational risk. This mortgage guaranty quality assurance program shall provide for the documentation, monitoring, evaluation and reporting on the integrity of the ongoing loan origination process based on indicators of potential underwriting inadequacies or non-compliance. This shall include, but not limited to:

(1) **Segregation of Duties.** Administration of the quality assurance program shall be delegated to designated risk management, quality assurance or internal audit personnel, who are technically trained and independent from underwriting activities that they audit.

(2) **Senior Management Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to an enterprise risk management committee or other equivalent senior management level oversight body.

(3) **Board of Director Oversight.** Quality assurance personnel shall provide periodic quality assurance reports to the board of directors or a designated committee of directors established to facilitate board of director oversight.

(4) **Policy and Procedures Documentation.** Mortgage guaranty quality assurance program, excluding policies and procedures of reinsurance, shall be formally established and documented to define scope, roles and responsibilities.

(5) **Underwriting Risk Review.** Quality assurance review shall include an examination of underwriting risks including classification of risk and compliance with risk tolerance levels.

(6) **Lender Performance Reviews.** Quality assurance monitoring provisions shall include an assessment of lender performance.

(7) **Underwriting Performance Reviews.** Quality assurance monitoring provisions shall assess compliance with underwriting standard.

(8) **Problem Loan Trend Reviews.** Quality assurance monitoring provisions shall assess prospective risks associated with timely loan payment including delinquency, default inventory, foreclosure and persistency trends.

(9) **Underwriting System Change Oversight.** Underwriting system program changes shall be monitored to ensure the integrity of underwriting and pricing programs, which impact automated underwriting system decision making.

(10) **Pricing and Performance Oversight.** Pricing controls shall be monitored to ensure that business segment pricing supports applicable performance goals.

(11) **Internal Audit Validation.** Periodic internal audits shall be conducted to validate compliance with the mortgage guaranty quality assurance program.

B. **Regulator Access and Review of Quality Assurance Program.** The commissioner shall be provided access to an insurer's mortgage guaranty quality assurance program for review at any reasonable ~~and thorough examination of the evidence supporting credit worthiness of the borrower and the appraisal report reflecting market evaluation of the property and has determined that prudent underwriting standards have been met~~time upon request and during any financial regulatory examination. Nothing herein shall be construed to limit a regulator's right to access any and all of the records of an insurer in an examination or as otherwise necessary to meet regulatory responsibilities.

Section ~~11~~14. Policy Forms and Premium Rates Filed

A. **Policy Forms.** ~~All P~~policy forms~~ and,~~ endorsements, and modifications (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall be filed with and be subject to the approval of the commissioner. With respect to owner-occupied, single-family dwellings~~, the mortgage guaranty insurance policy shall provide that~~ or a mixed-use building described in Section 2A(1)(b), which is owner-occupied at the time of loan origination and for at least 50% of the days within the twelve (12) consecutive months prior to borrower default, the borrower shall not be liable to the insurance company for any deficiency arising from a foreclosure sale.

B. ~~In addition, each mortgage guaranty insurance~~**Premium Rates.** Each mortgage guaranty insurance company (excluding bulk mortgage guaranty insurance and pool mortgage guaranty insurance) shall file with the ~~department~~commissioner the rate to be charged ~~and the premium~~ including all modifications~~ of rates and premiums to be paid by the policyholder~~.

C. **Premium Charges.** Every mortgage guaranty insurance company shall ~~adopt, print and~~ make available ~~a schedule of~~to insureds the premium charges for mortgage guaranty insurance policies.~~ Premium charges~~

~~made in conformity~~ via a company website or an integration with ~~the provisions of this Act shall not be deemed to be interest or other charges under any other provision of law limiting interest or other charges in connection with mortgage loans.~~ a third-party system. The ~~schedule~~premium rate provided shall show the entire amount of premium charge for ~~each~~the type of mortgage guaranty insurance policy to be issued by the insurance company.

Drafting Note: Open rating states may delete a portion or all of ~~this provision~~Section 14 and insert their own rating law.

Section ~~12. Outstanding Total Liability~~15. Risk in Force and Waivers

A. ~~A mortgage guaranty insurance~~ **Risk in Force.** A mortgage guaranty insurance company shall not at any time have outstanding ~~a total liability~~risk in force, net of reinsurance, under its aggregate mortgage guaranty insurance policies exceeding twenty-five (25) times its capital, surplus and contingency reserve. In the event that any mortgage guaranty insurance company has outstanding total ~~liability~~risk in force exceeding twenty-five (25) times its capital, surplus and contingency reserve, it shall cease transacting new mortgage guaranty business until such time as its total ~~liability~~risk in force no longer exceeds twenty-five (25) times its capital, surplus and contingency reserve. Total ~~outstanding liability~~risk in force shall be calculated on ~~a consolidated~~an individual entity basis ~~for all mortgage guarantee insurance companies~~.

B. **Waiver.** The commissioner may waive the requirement found in Section 15A at the written request of a mortgage guaranty insurer upon a finding that ~~are part of a holding company system~~the mortgage guaranty insurer's policyholders position is reasonable in relationship to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs. The request must be made in writing at least 90 days in advance of the date that the mortgage guaranty insurer expects to exceed the requirement of Section 15A and shall, at a minimum, address the factors specified in Section 15C.

C. **Waiver Criteria.** In determining whether a mortgage guaranty insurer's policyholders position is reasonable in relation to the mortgage guaranty insurer's aggregate insured risk in force and adequate to its financial needs, all of the following factors, among others, may be considered:

(1) The size of the mortgage guaranty insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force, and other appropriate criteria.

(2) The extent to which the mortgage guaranty insurer's business is diversified across time, geography, credit quality, origination, and distribution channels.

(3) The nature and extent of the mortgage guaranty insurer's reinsurance program.

The quality, diversification, and liquidity of the

(4) mortgage guaranty insurer's assets and its investment portfolio.

(5) The historical and forecasted trend in the size of the mortgage guaranty insurer's policyholders position.

(6) The policyholders position maintained by other comparable mortgage guaranty insurers in relation to the nature of their respective insured risks.

(7) The adequacy of the mortgage guaranty insurer's reserves.

(8) The quality and liquidity of investments in affiliates. The c ommissioner may treat any such investment as a nonadmitted asset for purposes of determining the adequacy of surplus as regards policyholders.

(9) The quality of the mortgage guaranty insurer's earnings and the extent to which the reported earnings of the mortgage guaranty insurer include extraordinary items.

(10) An independent actuary's opinion as to the reasonableness and adequacy of the mortgage guaranty insurer's historical and projected policyholders position.

(11) The capital contributions which have been infused or are available for future infusion into the mortgage guaranty insurer.

(12) The historical and projected trends in the components of the mortgage guaranty insurer's aggregate insured risk, including, but not limited to, the quality and type of the risks included in the aggregate insured risk.

D. **Authority to Retain Experts.** The commissioner may retain accountants, actuaries, or other experts to assist in the review of the mortgage guaranty insurer's request submitted pursuant to Section 15B. The mortgage guaranty insurer shall bear the commissioner's cost of retaining those persons.

E. **Specified Duration.** Any waiver shall be:

(1) For a specified period of time not to exceed two years; and

(2) Subject to any terms and conditions that the commissioner shall deem best suited to restoring the mortgage guaranty insurer's minimum policyholders position required by Section 15A.

Section 16. Conflict of Interest

A mortgage guaranty insurer may underwrite mortgage guaranty insurance on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate only if the insurance is underwritten on the same basis, for the same consideration and subject to the same insurability requirements as insurance provided to nonaffiliated lenders. Mortgage guaranty insurance underwritten on mortgages originated by the holding company system or affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly by the holding company system or affiliate shall be limited to 50% of the insurer's direct premium written in any calendar year, or such higher percentage established in writing for the insurer in the domiciliary commissioner's discretion, based on the domiciliary commissioner's determination that a higher percentage is not likely to adversely affect the financial condition of the insurer.

Section 17. Compensating Balances Prohibited

Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section. Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.

Section 18. Limitations on Rebates, Commissions, Charges and Contractual Preferences

A. ~~insurance~~**Inducements.** Unless set forth in the policy and subject to the [state equivalent of the Unfair Trade Practices Act #880], a mortgage guaranty insurance company shall not pay or cause to be paid either directly or indirectly, to any owner, purchaser, lessor, lessee, mortgagee or prospective mortgagee of the real property that secures the authorized real estate security or that is the fee of an insured lease, or any interest therein, or to any person who is acting as an agent, representative, attorney or employee of such owner, purchaser, lessor, lessee or mortgagee, any commission, or any part of its premium charges or any other consideration as an inducement for or as compensation on any mortgage guaranty insurance business.

B. **Compensation for Placement.** In connection with the placement of any mortgage guaranty insurance, a mortgage guaranty insurance company shall not cause or permit the conveyance of anything of value, including but not limited to any commission, fee, premium adjustment, remuneration or other form of compensation of any kind whatsoever to be paid to, or received by an insured lender or lessor; any subsidiary or affiliate of an insured; an officer, director or employee of an insured or any member of their immediate family; a corporation, partnership, trust, trade association in which an insured is a member, or other entity in which an insured or an officer, director or employee or any member of their immediate family has a financial interest; or any designee, trustee, nominee or other agent or representative of any of the foregoing, except for the value of the insurance itself or claim payments thereon as provided by contract or settlement.

C. ~~C.~~ ~~No mortgage guaranty insurance~~**Rebates.** Unless set forth in the policy and subject to the [state equivalent of the Unfair Trade Practices Act #880], a mortgage guaranty insurance company shall not make a rebate of any portion of the premium charge, as shown by the schedule required by Section ~~11C. No mortgage guaranty insurance~~14C. No mortgage guaranty insurance company shall not quote any rate or premium charge to a person that is different than that currently available to others for the same type of coverage. The amount by which a premium charge is less than that called for by the current schedule of premium charges is an unlawful rebate.

D. **Undue Contractual Preferences.**

(1) Any contract, letter agreement, or other arrangement used to clarify any terms, conditions, or interpretations of a master policy or certificate shall be documented in writing.

(2) Any contractual or letter agreements used to modify or clarify general business practices and administrative, underwriting, claim submission or other information exchange processes shall not contain provisions which override or significantly undermine the intent of key provisions of the mortgage guaranty insurance model act, including mortgage insurer discretion, rights and responsibilities related to:

(a) Underwriting standards.

(b) Quality assurance.

(c) Rescission.

E. **Sanctions.** The commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company, or in his or her discretion, issue a cease and desist order to a mortgage guaranty insurance company that pays a commission, rebate, or makes any unlawful ~~rebate~~conveyance of value under this section in willful violation of the provisions of this Act. In the event of the issuance of a cease and desist order, the commissioner may, after notice and hearing, suspend or revoke the certificate of authority of a mortgage guaranty insurance company that does not comply with the terms thereof.

~~**Section 14. Compensating Balances Prohibited**~~

F. ~~Except for commercial checking accounts and normal deposits in support of an active bank line of credit, a mortgage guaranty insurance company, holding company or any affiliate thereof is prohibited from maintaining funds on deposit with the lender for which the mortgage guaranty insurance company has insured loans. Any deposit account bearing interest at rates less than what is currently being paid other depositors on similar deposits or any deposit in excess of amounts insured by an agency of the federal government shall be presumed to be an account in violation of this section.~~ **Educational Efforts and Promotional Materials Permitted.** A mortgage guaranty insurance company may engage in any educational effort with borrowers, members of the general public, and officers, directors, employees, contractors and agents of insured lenders that may reasonably be expected to reduce its risk of Loss or promote its operational efficiency and may distribute promotional materials of minor value.

Section 19. Rescission

All mortgage guaranty insurance company master policies shall include a detailed description of provisions governing rescissions, re-pricing, and cancellations, which specify the insurer's and insured's rights, obligations and eligibility terms under which those actions may occur to ensure transparency.

Section 20. Records Retention

A. **Record Files.** A licensed mortgage guaranty insurance company shall maintain its records in a manner which allows the commissioner to readily ascertain the insurer's compliance with state insurance laws and rules during an examination including, but not limited to, records regarding the insurer's management, operations, policy issuance and servicing, marketing, underwriting, rating and claims practices.

B. ~~Furthermore, a mortgage guaranty insurance company shall not use compensating balances, special deposit accounts or engage in any practice that unduly delays its receipt of monies due or that involves the use of its financial resources for the benefit of any owner, mortgagee of the real property or any interest therein or any person who is acting as agent, representative, attorney or employee of the owner, purchaser or mortgagee as a means of circumventing any part of this section.~~

~~**Section 15.**~~ **Retention Period.** Policy and claim records shall be retained for the period during which the certificate or claim is active plus five (5) years, unless otherwise specified by the insurance commissioner. Recordkeeping requirements shall relate to:

(1) Records to clearly document the application, underwriting, and issuance of each master policy and certificate of insurance; and

(2) Claim records to clearly document the inception, handling, and disposition.

C. **Record Format.** Any record required to be maintained by a mortgage insurer may be created and stored in the form of paper, photograph, magnetic, mechanical or electronic medium.

D. **Record Maintenance.** Record maintenance under this Act shall comply with the following requirements:

(1) Insurer maintenance responsibilities shall provide for record storage in a location that will allow the records to be reasonably produced for examination within the time period required.

(2) Third-Party maintenance related responsibilities shall be set forth in a written agreement, a copy of which shall be maintained by the insurer and available for purposes of examination.

Section 21. No Private Right of Action

This Act may not be construed to create or imply a private cause of action for violation of its provisions nor may it be construed to curtail a private cause of action which would otherwise exist in the absence of this Act.

~~**Conflict of Interest**~~

~~A. If a member of a holding company system, a mortgage guaranty insurance company licensed to transact business in this state shall not, as a condition of its certificate of authority, knowingly underwrite mortgage guaranty insurance on mortgages originated by the holding company system or an affiliate or on mortgages originated by any mortgage lender to which credit is extended, directly or indirectly, by the holding company system or an affiliate.~~

~~A.~~ ~~B.~~ ~~A mortgage guaranty insurance company, the holding company system of which it is a part, or any affiliate shall not as a condition of the mortgage guaranty insurance company's certificate of authority, pay any commissions, remuneration, rebates or engage in activities proscribed in Sections 13 and 14.~~

~~**Section 16. Reserves**~~

~~A. Unearned Premium Reserves~~

~~A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve as set forth by regulation adopted by the commissioner of insurance.~~

~~B. Loss Reserve~~

~~A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves that accurately reflect loss frequency and loss severity and shall include components for claims reported and for claims incurred but not reported, including estimated losses on:~~

~~(1) Insured loans that have resulted in the conveyance of property that remains unsold;~~

~~(2) Insured loans in the process of foreclosure;~~

~~(3) Insured loans in default for four (4) months or for any lesser period that is defined as default for such purposes in the policy provisions; and~~

~~(4) Insured leases in default for four (4) months or for any lesser period that is defined as default for such purposes in policy provisions.~~

~~C. Contingency Reserve~~

~~Each mortgage guaranty insurance company shall establish a contingency reserve out of net premium remaining (gross premiums less premiums returned to policyholders net of reinsurance) after establishment of the unearned premium reserve. The mortgage guaranty insurance company shall contribute to the contingency reserve an amount equal to fifty percent (50%) of the remaining unearned premiums. Contributions to the contingency reserve made during each calendar year shall be maintained for a period of 120 months, except that withdrawals may be made by the company in any year in which the actual incurred losses exceed thirty-five percent (35%) of the corresponding earned premiums, and no releases shall be made without prior approval by the commissioner of insurance of the insurance company's state of domicile.~~

~~If the coverage provided in this Act exceeds the limitations set forth herein, the commissioner of insurance shall establish a rate formula factor that will produce a contingency reserve adequate for the added risk assumed. The face amount of an insured mortgage shall be computed before any reduction by the mortgage guaranty insurance company's election to limit its coverage to a portion of the entire indebtedness.~~

~~D. Reinsurance~~

~~Whenever a mortgage guaranty insurance company obtains reinsurance from an insurance company that is properly licensed to provide reinsurance or from an appropriate governmental agency, the mortgage guaranty insurer and the reinsurer shall establish and maintain the reserves required in this Act in appropriate proportions in relation to the risk retained by the original insurer and ceded to the assuming reinsurer so that the total reserves established shall not be less than the reserves required by this Act.~~

~~E. Miscellaneous~~

~~(1) Whenever the laws of any other jurisdiction in which a mortgage guaranty insurance company subject to the requirement of this Act is also licensed to transact mortgage guaranty insurance require a larger unearned premium reserve or contingency reserve in the aggregate than that set forth herein, the establishment of the larger unearned premium reserve or contingency reserve in the aggregate shall be deemed to be in compliance with this Act.~~

~~(2) Unearned premium reserves and contingency reserves shall be computed and maintained on risks insured after the effective date of this Act as required by Subsections A and C. Unearned premium reserves and contingency reserves on risks insured before the effective date of this Act may be computed and maintained as required previously.~~

Section ~~17~~22. Regulations

The commissioner shall have the authority to promulgate rules and regulations deemed necessary to effectively implement the requirements of this Act.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

1976 Proc. II 15, 17, 647, 686, 747-753 (adopted).
1979 Proc. I 44, 47-48, 49, 719, 968-969 (corrected).

Consumer Organizations' and NAIC Consumer Representatives' Comments to the

NAIC Mortgage Guaranty Insurance (E) Working Group

On the May 11, 2023 Exposure Draft of the Mortgage Guaranty Insurance Model Act

May 26, 2023

The undersigned NAIC consumer representatives and consumer organizations strenuously oppose the new provision eliminating a private right of action for violations of the act. While different from the "no private right of action" provision in the prior draft of the model law, the latest version of "no private right of action" in the May 11, 2023 exposure draft remains unwarranted and profoundly anti-consumer.

We also object to the watering-down of essential consumer protections.

A Private Right of Action is Necessary and Justified for Violations of Sections 8 (Advertising), 11A (Prohibition of Captive Reinsurance), 12 F (Nondiscrimination), 16 (Conflict of Interest), 18A (Inducements), 18B (Compensation for Placement), 18C (Rebates), 18F (Educational Materials) and 19 (Rescission)

The current NAIC mortgage guaranty insurance model act – adopted many years prior to the 2008 financial crisis – contains no provision limiting any consumer's right of action against the insurance company for violations of the act. It is unclear what rationale or basis or changes in the market exist to support the new "no private right of action" provision.

The current model includes, in Section 13, anti-rebating and anti-kickback provisions to protect consumers from collusion among mortgage insurers and lenders – practices that harm consumers. Despite these anti-kickback provisions in the model law, some insurance regulators not only failed to stop kickback schemes, such as captive reinsurance, but approved these anti-consumer schemes. Private rights of action garnered some relief for consumers who suffered losses because of the prohibited kickback schemes.

Historical experience demonstrates that regulatory oversight alone failed to protect mortgage guaranty insurance consumers and private rights of action helped address regulatory and market failures to provide some redress for harmed consumers. It is illogical that regulators would now insert a provision eliminating a private right of action for consumer redress in the revised model.

Industry's sole argument for the "no private right of action" is the ephemeral chestnut of "potential frivolous litigation." While we have pointed to justified litigation, industry has offered no examples of "frivolous litigation." We have previously pointed out that while industry wants to prevent consumers from going to court for protection against and redress from abusive mortgage guaranty insurer practices, the insurers themselves have no qualms about going to court against consumers. It would be an unfair double standard for regulators to endorse a "no private right of action" by consumers while leaving insurers' access to the courts untouched.

The addition of the "no private right of action" provision is unprecedented. There is no other personal line of insurance with such an anti-consumer provision. There is certainly no such provision in any of the NAIC model laws for lines of insurance that, like mortgage guaranty insurance, are subject to reverse competition – not for consumer credit insurance and not for title insurance.[1] Lines of insurance subject to reverse competition demand greater consumer protection tools, not fewer.

It would not be objectionable to limit the private right of action to only those provisions of the model for which consumer harm can be directly demonstrated and which avoid any provisions that would interfere with regulatory oversight of mortgage guaranty insurer solvency. A private right of action for violations of Sections 8, 11A, 12F, 16, 18A, 18B, 18C, 18F and 19 will not interfere with regulatory oversight of mortgage guaranty financial condition or market conduct – just as private rights of action for any other personal line of insurance complement regulatory oversight of insurers' market conduct in those other lines of insurance.

The revised "no private right of action" language – "neither creates a private right of action for violation of its provisions nor may it be construed to curtail a private right of action which would otherwise exist in the absence of the Act" – is very broad and could be interpreted to have the same effect as simply stating no private right of action. For example, the revised model now includes "limitations" on rebates, commissions and inducements instead of outright prohibitions. It is unclear what or how any other state laws specifically reference any of these prohibited practices and, consequently, how a private right of action would otherwise exist in the absence of the law. If a private right of action otherwise exists, it is likely because there is a federal law governing the behavior of mortgage insurers and state law will not usurp those private rights of action regardless of whether the new mortgage guaranty insurance model mentions "otherwise existing" private rights of action.

[1] "Reverse competition means competition among insurers that regularly takes the form of insurers vying with each other for the favor of persons who control, or may control, the placement of the insurance with insurers. Reverse competition tends to increase insurance premiums or prevent the lowering of premiums in order that greater compensation may be paid to persons for such business as a means of obtaining the placement of business. In these situations, the competitive pressure to obtain business by paying higher compensation to these persons overwhelms any downward pressures consumers may exert on the price of insurance, thus causing prices to rise or remain higher than they would otherwise." NAIC Credit Personal Property Model Act, 3X.

Watering Down of Important Consumer Protections

Section 18A is significantly weakened from a consumer protection standpoint. The model upends a fundamental anti-competitive practice – no inducements by insurers for the steering of business to the insurer – and makes such inducements permissible if included in the policy and subject to the Unfair Trade Practices Act. This is precisely the wrong way to regulate a line of business subject to reverse competition in which the insurers compete not for individual consumers, but for the lenders who select the mortgage guaranty insurer and steer the borrowers to those insurers. It was reverse competition in mortgage guaranty insurance markets that motivated a variety of inducement mechanisms to secure business from lenders leading up to the financial crisis of 2008. It was reverse competition that compromised mortgage guaranty insurers' risk management practices.

The recent revisions to the UFTA model act attempt to encourage risk mitigation efforts by insurers without conflicting with anti-rebate concerns. There is no risk mitigation associated with an inducement. Section 18A should be revised to delete the proposed addition at the beginning of the paragraph to clearly prohibit inducements.

The change to Section 18C – permitting rebates if set forth in the policy and subject to the UTPA – is also bewildering. The draft section states:

> Rebates: Unless set force (sic) in the policy and subject to the [state equivalent of the Unfair Trade Practice Act (Model #880)], a Mortgage Guaranty Insurance company shall not quote any rate or premium charge to a person that is different than that currently available to others for the same type of coverage. The amount by which a premium charge is less than that called for by the current schedule of premium charges is an unlawful rebate.

There is simply no way for a "rebate" as set out in the first phrase (set forth in the policy and subject the UTPA) to comply with the remaining portion of the paragraph. If the "rebate" is set forth in the filed rates, it is not a "rebate," but a rate discount. If the "rebate" is available to all for the same type of coverage, it is not a "rebate," but a rate discount. Further, reaching to the recent revisions of the NAIC UTPA model does not help; those recent revisions were intend to promote loss prevention and loss mitigation efforts without conflicting with anti-rebating prohibitions. If the "rebate" is set out in the policy form, then the UTPA is inapplicable because rebates are not policy form provisions approved by the regulator.

Private mortgage insurers do not engage in risk mitigation with borrowers – lenders and mortgage services are the entities that do such activities. While private mortgage insurers may engage in risk mitigation with lenders and servicers – because the mortgage insurance is for the benefit of the mortgage owner – there is no rationale for providing a "rebate" to lenders or services and such activity would clearly be a prohibited inducement or rebate.

Please contact Birny Birnbaum at birny@cej-online.org if you have any questions or would like additional information.

Center for Economic Justice
Consumer Federation of America
National Consumer Law Center (on behalf of its low-income clients)
United Policyholders
Amy Bach, NAIC Consumer Representative
Birny Birnbaum, NAIC Consumer Representative
Brendan Bridgeland, NAIC Consumer Representative
Bonnie Burns, NAIC Consumer Representative
Brenda Cude, NAIC Consumer Representative
Deborah Darcy, NAIC Consumer Representative
Yosha Dotson, NAIC Consumer Representative
Erica Eversman, NAIC Consumer Representative
Kara Hinkley, NAIC Consumer Representative
C. P. Hoffman, NAIC Consumer Representative
Karroll Kitt, NAIC Consumer Representative
Ken Klein, NAIC Consumer Representative
Peter Kochenburger, NAIC Consumer Representative
Matthew J. Smith, NAIC Consumer Representative
Harry Ting, NAIC Consumer Representative
Richard M. Weber, NAIC Consumer Representative
Jackson Williams, NAIC Consumer Representative
Silvia Yee, NAIC Consumer Representative

June 2, 2023

Ms. Jackie Obusek, Chair
Mortgage Guaranty Insurance (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street
Kansas City, MO 64106-2197
c/o Andy Daleo,
Senior Manager – Financial Regulatory Services

RE: MI Industry Group Comment Letter – May 2023 Model Act Exposure Draft

Dear Ms. Obusek:

The Private Mortgage Guaranty Insurance Industry Group ("Industry Group") submits the following comments with regard to Sections 10(B)(1) and 14(A) of the *Mortgage Guaranty Insurance Model Act* exposed on May 11, 2023 ("May 2023 Model Act").

Section 10(B)(1) – Contingency Reserve

The Industry Group recommends the following revision to draft Section 10(b)(1) and accompanying drafting notes for the Working Group's consideration. This proposal is meant to avoid adoption of a Model Act that would discourage the use of reinsurance by requiring the same amount of annual contribution to the Contingency Reserve irrespective of whether premiums are being ceded pursuant to a reinsurance agreement or treaty. Both a Contingency Reserve requirement and collateralized or otherwise specifically segregated assets required to be maintained pursuant to a reinsurance agreement or treaty serve the same function of providing assurance of claims paying ability. Form should not be elevated over function by granting credit towards the Contingency Reserve requirement only where the dedicated funding is able to be formally accounted for as a Contingency Reserve on a statutory financial statement, particularly since collateral held in a segregated trust could be considered to provide even more certain access to such funds for the cedent than assets commingled within a reinsurer's general investment portfolio to support a recorded Contingency Reserve entry.

The current exposure draft requires an annual contribution to the Contingency Reserve "*which in the aggregate shall be equal to fifty percent (50%) of the direct earned premiums reported in the annual statement or net earned premiums reported if the reinsurer maintains the contingency reserve.*" The Working Group addressed the interaction of reinsurance with the Contingency Reserve by adding the language "*or net earned premiums reported if the reinsurer maintains the contingency reserve.*" However, except in the case where the reinsurer is another mortgage guaranty insurance company, the impact of this language would unfortunately be illusory because reinsurers that are not mortgage guaranty insurance companies do not file a statutory financial statement that shows a contingency reserve entry.

The suggested drafting approach below would clarify that the Contingency Reserve requirement is deemed to be achieved based on the maintenance by the reinsurer of equivalent collateralized or otherwise specifically segregated assets supporting the reinsurance obligations, in trust or otherwise, even if the reinsurer does not file a statutory financial statement that shows a contingency reserve entry.

B. ***Contingency Reserve.*** *Each Mortgage Guaranty Insurance company shall establish a Contingency Reserve subject to the following provisions:*

(1) The Mortgage Guaranty Insurance company shall make an annual contribution to the Contingency Reserve which in the aggregate shall be equal to fifty percent (50%) of (a) the direct earned premiums reported in the annual statement or (b) earned premiums net of reinsurance reported if the reinsurer maintains the Contingency Reserve or equivalent assets that support its reinsurance obligation. Credit for maintenance of the Contingency Reserve or equivalent assets in connection with reinsurance shall apply to the extent of and during the period that such amounts are maintained. In the event of a release of such amounts before the 120 month period in subpart (B)(2) of this Section for any reason other than as approved under subpart (B)(3) of this Section, the Mortgage Guaranty Insurance company shall reestablish such amounts in its Contingency Reserve effective as of the date of the next annual contribution to the Contingency Reserve.

In conjunction with this version of Section 10(B)(1), we also propose adding the following drafting note:

Drafting Note: *As used in this section, the term "reinsurance" includes traditional forms of insurance as well as other similar mechanisms or constructs, such as insurance linked notes with a reinsurance feature, that permit the primary direct insurer to transfer risk in a manner that allows that insurer to record such risk transfer and any capital support attendant thereto either as an asset or a reduction from liability on its statutory financial statements in accordance with statutory accounting principles. As used in this section, the phrase "equivalent assets" includes the maintenance by the reinsurer of collateral in a trust or segregated account to support the reinsurer's obligation, or the direct insurer recording a liability for funds held under the reinsurance treaty.*

Finally, we also offer an optional drafting note that may accompany Section 10 to the extent that the Working Group deems it to be helpful. While the Industry Group does not view it to be essential, the optional drafting note is intended to memorialize, for the avoidance of any doubt, that the contingency reserve provision in this model law that is unique to the mortgage guaranty insurance line should not be construed as being in conflict with the provisions of either the Covered Agreement or the NAIC's separate model law relating to credit for reinsurance.

Drafting Note: *In accordance with The Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance ("Covered Agreement"), states should not interpret this section in a manner that would violate or contravene the Covered Agreement. Nothing in this section is intended to be in conflict with NAIC Model 785 Credit for Reinsurance Law or NAIC Model 786 Credit for Reinsurance Regulation.*

Section 14(A) – Policy Forms

The Industry Group continues to recommend the deletion in its entirety of the second sentence in Section 14(A) relating to deficiencies arising from a foreclosure sale.

Citing experiences from the great financial crisis involving moral hazards such as the temptation of a borrower to strategically default on a mortgage loan notwithstanding having the financial wherewithal to repay amounts due, the Industry Group previously commented that the ability to evaluate loans for pursuit of deficiency actions on a case by case basis supports the overall solvency of the mortgage guaranty insurance industry.[1] There is a divergence among states with regard to the pursuit of deficiency judgments -- many states permit such actions while some states have passed an anti-deficiency judgment law of general effect that applies to both loan servicers and mortgage guaranty insurers alike. We commented that it would be an anomalous result if scenarios were to arise in certain states where the loan servicer is allowed to pursue the borrower for a deficiency arising from a foreclosure sale while the mortgage insurer is restricted from doing so.[2] Finally, we offered reassurance to the Working Group that in those states that do have anti-deficiency judgment acts, the Master Policy form already acknowledges the limitations on the mortgage guaranty insurer to pursue deficiencies arising from a foreclosure sale in those particular jurisdictions.[3] Therefore, we requested to remove this sentence from the Model Act draft exposed in October 2022.

Following the submission of the November 18, 2022 Comment Letter, the Working Group did, in fact, remove the language referring to deficiency actions from the February 2023 Model Act exposure draft, but appeared to have inadvertently retained a fragment of the sentence. Believing this to be a typographical error in need of correction, we flagged this sentence fragment in the attachment to our March 14, 2023 Comment Letter. However, the May 2023 Model Act corrected the typographical error by restoring the original draft prohibition on pursuit of deficiency actions, rather than by deleting the sentence fragment. Therefore, we again raise this matter to the Working Group's attention and request to remove the second sentence of Section 14(A) in its entirety for the reasons in our prior comment letter and summarized above.

Conclusion

The Industry Group supports the Working Group's efforts to update the Model Act, and we would be pleased to make representatives of each company available for a telephonic conference to discuss the comments in this letter if that would be of assistance to you.

Respectfully submitted on behalf of the Industry Group companies below,

Arch Mortgage Insurance Company,
Enact Mortgage Insurance Corporation,
Essent Guaranty, Inc.,
Mortgage Guaranty Insurance Corporation,
National Mortgage Insurance Corporation, and
Radian Guaranty Inc.

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[1] *See* Industry Group Comment Letter dated November 18, 2022, at 11.
[2] *See id.* at 12.
[3] *See id.*

Draft: 5/8/23

Restructuring Mechanisms (E) Working Group
Virtual Meeting
May 4, 2023

The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met May 4, 2023. The following Working Group members participated: Elizabeth Kelleher Dwyer, Co-Chair, and Matt Gendron (RI); Glen Mulready Co-Chair, and Andrew Schallhorn (OK); Leo Liu (AR); Rolf Kaumann (CO); Jared Kosky and Jack Broccoli (CT); Judy Mottar and Vincent Tsang (IL); Robert Wake (ME); Judy Weaver (MI); Fred Andersen (MN); John Rehagen (MO); Lindsay Crawford (NE); John Sirovetz (NJ); Bob Kasinow (NY); Dale Bruggeman (OH); Diana Sherman (PA); Amy Garcia (TX); Doug Stolte and David Smith (VA); Steve Drutz (WA); and Amy Malm (WI).

1. Receive and Consider Comments on Exposed Draft Guidance & New Language to Address Previous Comments

Superintendent Dwyer announced that during the April 4 meeting, the Working Group exposed draft Best Practices guidance and requested wording to address issues discussed during the meeting. Superintendent Dwyer noted the Working Group received twelve comments (Attachment Four-A) and the discussion will focus on the comments received related to the exposed redline changes, as well as the new language to address previous comments, that later of which will be exposed sometime after this call.

a. Accreditation Requirements

Superintendent Dwyer explained that with respect to the question of making the Best Practices document currently being developed and debated and accreditation requirement, the product would proceed to the Financial Condition (E) Committee. They would decide whether to refer the Best Practices to the Financial Regulation Standards and Accreditation (F) Committee, who would decide what portions, if any, of the Best Practices document would become an accreditation standard.

b. Guaranty Fund Coverage

Robin Marcotte (NAIC) summarized the comments on the next issue dealing with retaining guaranty fund coverage. Superintendent Dwyer asked for comments from individuals that did not support the existing language in the draft Best Practices document on the topic of guaranty fund coverage. Wayne Mehlman (American Council of Life Insurers—ACLI) stated they support the existing language on guaranty fund coverage in the Best Practices document. Kristen DiCarmine (New York Life) stated they had no objections and that they would follow the document as it is considered at various stages for accreditation. Rehagen stated appreciation for the language included but noted that he was struck that the legal opinion requirement was removed. Superintendent Dwyer explained that as an attorney, she would prefer the company tell her as a regulator whether their attorney opines on the guaranty fund protection being retained. She explained that within the departments of insurance, she believes they understand the issue well enough and if they do not, she is not sure they could seek a legal opinion but that would be a reason for not requiring a formal legal opinion.

Bill O'Sullivan (National organization of Life and Health Guaranty Associations—NOLHGA) stated he agreed with Superintendent Dwyer on the reason for removing the legal opinion language because guaranty fund coverage, both on the life and property casualty side, will be determined at the time the company is placed into liquidation. He stated there could be all sorts of factors in making the determination regarding potential limitation and exclusions of coverage that would be difficult to estimate at the time of the transaction. He stated he believes it was more important is that certain factors are met and as included in the previously exposed revised language. Superintendent Dwyer stated that as an attorney, she preferred that to a representation at a point in time from some outside law firm. Rehagen stated that he was concerned that all states would not adopt the language but since the language has specific factors that must be addressed and assessed, he found the reason for taking that certification requirement out of the draft Best Practices document. Robert Romano (Norton Rose Fulbright and on behalf of Protucket Insurance Company) stated their comment is focused on the distinction between how guaranty fund coverage for life and health and property and casualty are managed and that at least in theory, they should be the same in the end. O'Sullivan responded that for life and health coverage, for there to be guaranty fund coverage, the insurer must be a member of the state guaranty fund association, which means they must be licensed or have been licensed in the state. Barbara Cox (National Conference of Insurance Guaranty Funds—NCIGF) stated that for property casualty business, the insolvency company must issue the covered business. She stated that NCIGF supports state regulation and that it would be good if the successor insurer was also a licensed insurer under the supervision of the state regulator, but current that does not ensure coverage on the property casualty side. The Receivership and Insolvency (E) Task Force is currently modifying the language that will address this issue. Cox noted the hope was for the language to be adopted by the Summer National Meeting. Romano suggested that once the language Ms. Cox is referring to is adopted by all the states, the Best Practices document will need to be updated. Peter L. Hartt (Randall and Quilter) stated they defer to the expertise of others, but they were simply looking for clarification on the purpose of licensure is. Superintendent Dwyer responded that she believes the guaranty fund representatives were correct that while licensure is especially important in life and annuity, not as important you sometimes could have coverage and guaranties in property and casualty in a separate way. Superintendent Dwyer asked one final time for objections to the previously exposed language for this item, as well as editorial changes for the remainder of the section and there were none.

c. Independent Expert

Marcotte summarized the comments on the next issue dealing with the use of an independent expert. Mehlman stated that the ACLI principles on this topic require an independent expert on both an insurance business transfer (IBT) and a corporate division (CD), and the development of such principles was after months of negotiations between members. Superintendent Dwyer noted that this issue had been discussed extensively and noted she believed most everyone believes that most transactions there is a need for such an expert, but that the Department's staff knows the company and the Department would on occasion find that and independent expert was not necessary. Superintendent Dwyer added that as drafted, this would require the Department to set that out and make a very explicit statement on why. Mehlman responded that they appreciate that but that he can only restate what is in the ACLI principles that require an independent expert regardless. Birny Birnbaum (Center for Economic Justice—CEJ) stated his company takes no issue with the language, but noted it demonstrates a greater need for a policyholder advocate. He noted it is unclear where there would be any kind of public report assessing the impact on policyholders and if there is no independent expert then there is really an even greater need for policyholder advocates to be part of the process. Superintendent Dwyer asked one final time for objections to the previously exposed language for this item, as well as editorial changes for the remainder of the section and there were none.

d. Other Redline Changes Edits to Previously Exposed Draft Best Practices

Superintendent Dwyer asked for objections to the remaining redline changes in the previously exposed document, as well as editorial changes noted by NAIC staff and the chair, and there were none.

e. New Language on Proforma Financials

Marcotte summarized the comments on the next issue dealing with proforma financial statements noting that both comments support the position of the Working Group on this issue. Birnbaum stated that while three years of proforma financial statements may be adequate for some types of analysis associated with these proposed transactions, it is certainly not enough time to consider the treatment of policyholders. This would include for example fees, expenses, and changes thereon that gets at servicing issues. An example would be a transaction dealing with variable annuities where the transferee has a history of increased expense provisions on those types of products. There were no additional comments, but the revised language will be included for additional comments in the next exposure.

f. New Language on Evaluating Policyholder Impacts & Not Creating Monoline Insurers

DiCarmine discussed their previous comments discussed during the last call on no worse off and how to evaluate that and how their proposed language submitted attempts to address this concern of theirs. Malm asked for clarification of the use of the term monoline insurers since that has a connotation among regulators to include things such as mortgage guaranty insurance and financial guaranty insurance. Superintendent Dwyer suggested something like "the domestic regulator should consider whether the transfer or the transferee will become a monoline company following the transaction. Birnbaum suggested the idea of the concern is good and for whatever that means for a life insurer but questioned the language fix. He set forth a number of related issues that he thinks should be addressed in the financial analysis of the receiving company. Superintendent Dwyer suggested perhaps "consider or evaluate" is better than "ensure" to leave room for those lines of business. DiCarmine described how supplemental benefits could be an example of a life insurer monoline of business where perhaps the transferor previously sold life and annuities as well. Marcotte suggested the better term might be diversification. Superintendent Dwyer agreed with Marcotte and suggested this language be modified in the next version of the draft Best Practices.

g. New Language on Policyholder Advocate

Superintendent Dwyer stated that she understood the concerns raised in the comment letter by the Center for Economic Justice but that personally having worked at an insurance department for 25 years, she believes that the states are the policyholder advocate. Superintendent Dwyer noted that while the commentor believes there is a conflict, she respectfully disagreed with that view. Superintendent Dwyer asked if there were others that shared similar views. Bonnie Burns (California Health Advocate) stated she supported the comments from the Center for Economic Justice. Burns stated that while departments can help consumers with these issues, those consumers may not get to a department of insurance for a variety of reasons. Burns noted she has a lot of experience with people who have questions beyond what the department of insurance can manage.

Superintendent Dwyer asked for an example. Burns noted that if a consumer was considering taking legal action and has indicated such to the department of insurance who is unable to help with information. Or sometimes there are provider issues that come up outside of the department's expertise. Birnbaum stated that the way the draft Best Practices was currently structured, there is a communication plan that alerts policyholders to the business transfer and gives the consumer an opportunity to participate in any kind of public forum. So, the problem is if the consumer calls in and makes a comment its not framed in a way that is helpful to the regulator because the consumer does not really understand the process and does not understand the requirements placed upon the regulator to decide. If there were a policyholder advocate, they could not only take the information provided to them for serving in that capacity, and they could also sort of supplement that information with additional information from the consumer and other consumers and put into the context that is relevant for the regulator to consider. He described how in a long-term care rate filing, many regulators hold a hearing on those types of issues, where the consumer calls in, makes comments, but they are not comments that a regulator can use in terms of the requirements. As previously noted, a policyholder advocate could assist in the situation. Burns noted how she was a consumer, and this was not her area of expertise and would be relying on Birnbaum. Burns noted that consumers come to her for information about how things affect them and what if anything they can do to assist and people in the insurance department are unable to talk to them in that way. Superintendent Dwyer responded that she wanted to be clear, but that she was not saying that policyholder advocates and things that consumer advocates do have no value. She noted that long-term care rate filings and provider issues are not what is at issue, rather the issue is whether a book of business should be transferred from one company to another without any change in the policy. Birnbaum agreed this was different than a proceeding to approve a policy form or a rate but there is a similarity and while he understands that its regulators responsibility to make sure there are no adverse or materially adverse impact on those policyholders, but any type of situation in which there an impact on policyholders and the benefits of having a policyholder advocate. Superintendent Dwyer asked the members of the Working Group if any of them wanted to change their view on this issue and the addition of such language and no one responded.

h. <u>Hong Kong Legislation</u>

Marcotte noted that Dave Wolf (NJ) had provided some language on the Hong Kong legislation that he had some previous experience with and had questioned on the April 4 call if it included "material" in its requirement of an adverse effects. The Working Group deferred discussion on the topic until NAIC staff could review the legislation more closely and Mr. Wolf could be on to discuss more specifically his view.

i. <u>No Material Adverse Effects</u>

Superintendent Dwyer noted this issue was discussed on the last call and the Working Group expressed a preference for using "material" specifically in addition to "no adverse effect." Robert Woody (American Property Casualty Insurers Association—APCIA) noted how this standard had been used in other places and how he thought there are some circumstances where material might even be defined. Without such a standard, the door could be opened to very minor issues becoming an obstacle to a transaction. Stephen DiCenso (Milliman) noted that he thought the comments he submitted stand on their own and if there needs to be further elaboration, there is some documentation in the minutes of an example that he provided. Romano stated his agreement and that there needed to be changes made throughout the document for consistency. Hartt agreed with the other comments and too also emphasized the need for consistency throughout the document. Birnbaum noted that industry seems to favor the no material adverse effect language which seems to imply there can be some assessment of all policyholder with one assessment when in fact if you look at the corporate division narrative, it refers to evidence demonstrating that the interests of all classes of policyholders and stakeholders will be protected. There could be a variety of positive and negative effects and part of this has to do with material, which is who gets to decide what is material. The question is how you determine what a material adverse effect is and how do you ensure consistency or uniformity across the states. Stolte stated he agreed with Birnbaum and more specifically that he does not think a policyholder should have any adverse impact from one of these transactions; something he finds problematic. Superintendent Dwyer noted she would ask NAIC staff to draft up something that will be included in the next exposure.

j. Other Comments

Marcotte noted that comments were received on the topic of runoff, and as has been noted in the past, the inclusion of that topic in the current Best Practices was related to the fact that the group was charged to address the issue but that ultimately that topic may need to be placed elsewhere in a different document. Carolyn Fahey (AIRROC) expressed AIRROCs willingness to work with the Working Group to further examine some of the questions related to runoff and the distinct differences between runoff and restructuring. Mehlman asked about the status of the White Paper. Superintendent Dwyer responded that the White Paper was waiting on these Best Practices and that once these are finished, they will be incorporated into the White Paper, by reference. Superintendent Dwyer stated they are trying to get both done by the end of the year.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.

https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/2023-2-Summer/Restructuring Mech WG/5-4-23/5-4-23 Restructure WG.docx

Draft: 4/20/23

Restructuring Mechanisms (E) Working Group
Virtual Meeting
April 4, 2023

The Restructuring Mechanisms (E) Working Group of the Financial Condition (E) Committee met April 4, 2023. The following Working Group members participated: Elizabeth Kelleher Dwyer, Co-Chair, and Matt Gendron (RI); Glen Mulready Co-Chair, and Andrew Schallhorn (OK); Leo Liu (AR); Rolf Kaumann (CO); Jared Kosky and Jack Broccoli (CT); Fred Moore, Judy Mottar, and Vincent Tsang (IL); Robert Wake (ME); Judy Weaver (MI); Fred Andersen (MN); John Rehagen and James Le (MO); Lindsay Crawford (NE); David Wolf (NJ); Bob Kasinow (NY); Dale Bruggeman (OH); Diana Sherman (PA); Amy Garcia (TX); Doug Stolte and David Smith (VA); Dan Petterson (VT); Tim Hays (WA); and Amy Malm (WI).

1. <u>Discussed the Merger of the Restructuring Mechanisms (E) Subgroup into the Restructuring Mechanisms (E) Working Group</u>

Superintendent Dwyer said at the Spring National Meeting, the merger of the Restructuring Mechanisms (E) Subgroup into the Restructuring Mechanisms (E) Working Group was announced during the Financial Condition (E) Committee meeting. It was also noted that the membership and charges would be merged into the Working Group, with Ohio added as one new member. Members were asked to contact NAIC staff if they would like to make any changes to their listed representative; although, it was noted that a merger of the two groups is appropriate given that many of the representatives are the same. Superintendent Dwyer noted that the Subgroup developed a first draft of regulatory principles and best practices for insurance business transfers (IBTs) and corporate divisions (CDs), but the merged Working Group would now complete that work. Commissioner Mulready stated that the goal is to have all products of the Working Group, including the best practices, finalized by the Fall National Meeting.

2. <u>Adopted the Restructuring Mechanisms (E) Subgroup's Nov. 9, 2022, Minutes</u>

Malm made a motion, seconded by Commissioner Mulready, to adopt the Restructuring Mechanisms (E) Subgroup's Nov. 9, 2022, minutes (*see NAIC Proceedings – Fall 2022, Financial Condition (E) Committee, Attachment Seven*). The motion passed unanimously.

3. <u>Exposed Proposed Revisions to Best Practices</u>

Superintendent Dwyer announced that included in the materials were proposed revisions to the best practices that address: 1) the use of an independent expert for CDs; and 2) language to address comments from the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and the National Conference of Insurance Guaranty Funds (NCIGF). The concept of the changes was previously authorized by the Restructuring Mechanisms (E) Subgroup, and NAIC staff developed language to address both concepts. Superintendent Dwyer indicated that there was a desire to expose the proposed revisions for a 21-day public comment period ending April 26 so the comments could be discussed during the Working Group's next meeting, which is scheduled for May 4. Rehagen stated that the exposure period is shorter than normal, but he appreciates the reason and is therefore not opposed to it. Superintendent Dwyer indicated that the changes appear to be non-controversial and therefore proposed a shorter proposed exposure period, but comments may suggest otherwise which would cause another exposure period. William O'Sullivan (NOLHGA) stated his appreciation for NAIC staff working with him on the changes that are intended to preserve guaranty fund coverage by requiring the successor entity to continue to be licensed in the appropriate jurisdictions. Superintendent Dwyer noted that the Receivership and

Insolvency (E) Task Force is developing changes to the *Property and Casualty Insurance Guaranty Association Model Act* (#540) that would provide similar assurances for property/casualty (P/C) contracts.

Kaumann made a motion, seconded by Commissioner Mulready, to expose the revisions to the best practices until April 26. The motion passed unanimously.

4. Heard an Update on RBC Runoff Referrals

Bruggeman stated that the referral from the Working Group to the Property and Casualty Risk-Based Capital (E) Working Group had been discussed, and after that, the Capital Adequacy (E) Task Force requested that the Health Risk-Based Capital (E) Working Group and the Life Risk-Based Capital (E) Working Group also review and discuss it. He noted that the Life Risk-Based Capital (E) Working Group reviewed and discussed the issue of runoffs for its formula, and it concluded that no changes were needed. He also noted that the Health Risk-Based Capital (E) Working Group came to the same conclusion as the Property and Casualty Risk-Based Capital (E) Working Group, which is that resulting insurers should be monitored through the state analysis and examination functions. They also concluded that if a change is ultimately made to the health risk-based capital (RBC) formula, they would recommend that it be defined as a voluntary or involuntary , and includes the characteristics of: 1) non-renewing of policies for at least 12 months; 2) no plan or intention to write new business or assume new business; and 3) no additional runoff blocks of business. Additionally, if the remaining reserves are zero, the runoff is probably complete or almost complete.

5. Continued Discussion of the Review of Previously Submitted Comments

A. No Worse Off

Superintendent Dwyer noted that the first topic that has been discussed by the Restructuring Mechanisms (E) Subgroup but for which the Restructuring Mechanisms (E) Working Group would need to conclude is the issue of "no worse off" language. Superintendent Dwyer stated that standards such as "best interest of the policyholder" or "no material adverse effect," was the United Kingdom (UK) standard and standards previously interpreted by Courts provide a clearer standard. Commissioner Mulready noted that Oklahoma modeled the language in its law after the Part VII UK standard, and he suggested the same for these NAIC best practices. He noted that the "no material adverse effect" language has worked for over 20 years and over 300 transactions.,. Stolte stated that Virginia prefers "no worse off" since it does not believe a policyholder should experience any type of adverse impact, and materiality is in the eye of the beholder. Commissioner Mulready responded that he appreciates the comment on materiality, but he noted that the process is so robust, and the materiality in the process would be in the eyes of the independent expert, as well as the state insurance regulator and the judge.

Superintendent Dwyer stated that while the standards are financial, language that has previously been used and for which case law exists would be preferred. She noted that it was not clear where "no worse off" language was derived from. Stolte noted that they were not lawyers, but they were just trying to protect the policyholders in the transaction. He noted that this would have no impact on Virginia policyholders because of the Virginia anti-novation law, and the company would be required to come to the Virginia state insurance regulator for approval. Smith added that the "no worse off" language was a compromise between the best interests of the policyholders and the "no material adverse effect." Kosky noted that Connecticut law uses a best interest rule, and its CD law uses similar language.

Luann Petrellis (Catalina Re) voiced support for the " no material adverse impact" standard. It has been widely used through the UK Part VII Transfers for many years without any subsequent financial difficulties in any transaction. She also emphasized that materiality is a universally accepted standard of review, and there is a wealth of legal precedent interpreting what that means. There is an aspect of subjectivity in any of these standards, but there are tried and true tested procedures with material adverse impact, and there have been successfully completed transactions in the U.S. that utilized that standard. Petrellis noted that during legislative processes on this topic, everyone in the industry from all points of view agreed with this language, and using any other standard would likely result in inconsistency. Stephen DiCenso (Milliman) provided an example of the issue, noting that if an insurer had an RBC of 500, and then after the transaction it was 400, some might argue that the policyholder was worse off, but in either of those two cases, judgment would indicate that there is no material impact. That example supports the "no material adverse effect" standard. Peter L. Hartt (Randall and Quilter) stated that he concurs with the comments from DiCenso and Petrellis, and he stated that Randall and Quilter's concerns would be the unintended consequences of experimenting with new terminology that has not been well tested. Kristen DiCarmine (New York Life) noted that the points raised in its joint letter are different than those others have made, and she emphasized that there are some financial and administrative elements that would help to define "no worse off" or not materially adverse. She suggested adding language that would address this comment. Superintendent Dwyer asked DiCarmine to send in such language.

James Mills (Enstar) stated that "no material adverse effects" goes beyond just UK Part VII Transfers, and more precisely, it is a term of art used broadly in contract evaluation. He noted that there was a comprehensive framework that would be used, and it is important to recognize what exists in statutes that legislatures have enacted. He agreed with the point made by DiCenso, and he argued that any dividend payment by an insurer would be detracting from the financial stability of its policy, but state insurance regulators evaluate capital adequacy, not capital maximization, within insurers, and there are difficulties in the insurance industry. Stolte responded that these are best practices, and in Virginia, its law is to consider the best interests of the policyholder, and nothing done by the Working Group will change that. Superintendent Dwyer agreed with Stolte regarding nothing within the Working Group changing Virginia law, and the same goes for other state laws. She stated the Working Group's product will be to set high financial standards for these transactions. She asked if there were states besides Virginia and Connecticut that were against the use of the "no material adverse effect."

Broccoli responded that Connecticut is fine with that standard for IBTs, and its position previously described was with respect to CDs. No other states responded. Superintendent Dwyer summarized that the Working Group would utilize "no material adverse effect." She added that the Working Group will work on this further regarding how to measure the standard. It will also look at whether the standard would be different for reinsurers. Wolf asked if it would be possible to remove material from the standard. He believes that the standard in Hong Kong was "no adverse effect on policyholders." Superintendent Dwyer stated that in addition to the concepts mentioned by New York Life, the Working Group would ask Wolf to provide information on the Hong Kong standard.

B. Due Process

Rehagen noted that in Missouri, it is illegal to transfer policies without policyholder consent, as it pertains to assumption reinsurance. Superintendent Dwyer stated in such a situation, it would be up to the court to decide. She asked if there was specific language in the standards as far as the coordination of other states or access to the filings. Rehagen said years ago, there were some transactions for which effected states were not notified, however, communication between the states has greatly improved. He suggested a requirement that states be notified ahead of time. Superintendent Dwyer stated that requiring the state to notify and coordinate might be fine but advised against specifics regarding the format of communication deferring to the most efficient method of delivery. Robin Marcotte (NAIC) discussed how the current best practices draft suggests requiring a communication plan from the company, which then needs to be approved by the state insurance regulator. The current draft requires that this plan coordinate with other affected state insurance regulators and allowing them to have adequate time to assess the impact and the opportunity to submit written comments or attend public hearings. Gendron stated that clarification is needed as to when notification is required and who is responsible for that notification.

Birny Birnbaum (Center for Economic Justice—CEJ) discussed how the parties receiving notice other than the policyholders have the resources and expertise to meaningfully engage the process. He stated that consequently, there is a need for a policyholder advocate as part of the process. This position would receive and interpret comments from policyholders or simply answer questions when they do not understand the notice they receive. Birnbaum also stated that with respect to the independent expert, this person would likely focus on those things that can be easily quantified, such as material impact and administration capacity. He stated that this would be necessary for personal policies and commercial policies that are more similar to personal policies, such as small business policies. Superintendent Dwyer asked Birnbaum how that person would be defined and what language he would propose to address this issue. Birnbaum responded that the establishment of the policyholder advocate would be part of the process, as well as part of the communication plan, but it would also need to have access to the same kind of confidential information as the state insurance regulator. Commissioner Mulready responded that he believed that was part of the process already, as the current three-step process includes ensuring that there is no material adverse impact on the policyholders by the independent expert. He noted that the state insurance regulator is also already meant to protect the consumer, and the judge is reviewing the information to conclude that it is for that purpose.

DiCarmine noted the need to ensure opportunities for policyholders to meaningfully participate, both in person and remotely. Superintendent Dwyer stated that current statutes make provisions for this and there might be additional participation through Court order. Birnbaum questioned what the policyholder would do without a policyholder advocate that could more easily consider the complexity of the transaction and multiple moving parts. Thus, he asserted that participation would likely not be meaningful because the policyholder does not have the resources or skill set to evaluate the transaction. This advocate would not diminish the commissioner's role. Superintendent Dwyer explained that in this situation, the insurance department would sit down with the policyholder to explain the transaction to them. Wayne Mehlman (American Council of Life Insurers—ACLI) stated that for IBTs and CDs, while the ACLI does not suggest the need for policyholder consent, it suggests the need to require notice, a public hearing, and an independent expert for a review.

C. Do Not Create Monoline Companies

DiCarmine stated a comment on not allowing IBT and CD to create monoline companies was included in comments that were made by New York Life and two other insurers. She stated that New York Life could work on some language for the Working Group to consider.

D. Pro Forma Financial Statements

Superintendent Dwyer stated that the next issue deals with financial strength and how many years of pro forma financial statements are needed. Weaver stated that the Restructuring Mechanisms (E) Subgroup discussed the question of three or five years, but noted that Michigan requires five years. Consequently, five years was recommended by Weaver, but she also suggesting that the domestic regulator would have the ability to require more than five years in the appropriate circumstances. Malm stated support for five years with the potential for more depending upon the line of business. Commissioner Mulready stated that the Oklahoma statute requires three years, but more can be requested. He suggested that five years seemed like too many. Kosky agreed with Commissioner Mulready, and he noted that Connecticut requires three years, with more in the appropriate situation. Broccoli agreed with Kosky and Commissioner Mulready, but he noted that if the company has no access to capital, a state insurance regulator would probably want a longer period of time, even more than five years.

E. CD Procedures Similar to Form A Procedures

Kosky stated that Connecticut made comments at a past Restructuring Mechanisms (E) Subgroup meeting that it views the process for reviewing a CD similarly to a Form A Change in Control. Kosky noted that it has always been Connecticut's plan to review CDs under the same lens as a Form A. He also noted that under Connecticut law, the commissioner shall approve the division unless the commissioner finds that the interest of any policyholder will not be adequately protected or constitutes fraud. Marcotte noted that Locke Lord LLP made similar comments on the Subgroup's exposure. Superintendent Dwyer suggested language that indicated that for a CD or anything that an actual court of record does not approve, there must be a robust process within the department. Kosky suggested that there be six or seven standards would be appropriate for a CD that the commissioner review regarding approval. Superintendent Dwyer asked about a hearing. Kosky stated that the law was a "may" standard for the commissioner in holding a hearing as deemed appropriate. Marcotte described how in the current proposed best practices, there was an intent to avoid duplication between listing the same standards for IBTs and CDs, and many of the financial review requirements are combined unless there is a specific statement about something being different between the two.

F. Retention of Licenses

O'Sullivan noted that comments have been made to the Working Group and the Restructuring Mechanisms (E) Subgroup since their inception regarding a need for an insurance company to retain its licenses in states after an IBT or CD to retain guaranty fund coverage. He noted that for life insurers, any successor company needs to retain its licenses in its states to be considered a member of the guaranty fund association and, therefore, provide guarantee fund coverage. He noted that there were some regulatory discussions that some sort of streamlined licensing may be needed to address this issue. Wake indicated concern about the unintended consequences of requiring states to automatically license all surviving companies. Superintendent Dwyer asked about the status of the #540 model language at the Receivership and Insolvency (E) Task Force. O'Sullivan indicated that such changes were meant to address issues related to P/C. Wake noted that there was a consensus of the Task Force to use a surgical approach with limited changes. He noted that if licenses were not retained, there was concern about straining the orphan clause and existing coverage in the domestic state. He noted that that was perhaps not a bad consideration because it forces the domestic state to think through the transaction, given the ramifications if things do not go well.

Peter Gallanis (NOLHGA) discussed the decision at the Task Force to not address the life issues with an IBT and CD because of the fundamental differences between the P/C and life and health. For instance, there are differences in the types of contracts that are covered in P/C and life and health. Gallanis noted his concern that tugging on a thread in this sweater could have unintended consequences. Therefore, the recommendation for life and other long-term contracts issued by life insurers is to have the same licensure in the same states post-transaction and pre-transaction. If that cannot be met, perhaps the transaction should not be approved.

Weaver noted that the Financial Analysis (E) Working Group has made some reference or referrals to the National Treatment and Coordination (E) Working Group that states have seen issues in which other states are not ensuring that companies are licensed in the states when there is a merger. This step is needed to ensure states can properly regulate and oversee that business.

Having no further business, the Restructuring Mechanisms (E) Working Group adjourned.

https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/2023-2-Summer/Restructuring Mech WG/4-4-23/4-4-23 Restructure WG.docx

Restructuring Mechanisms (E) Subgroup
4-26-23 Comments

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To: Restructuring Mechanisms (E) Working Group
Re: Best Practices Redline Exposure April 2023
Date: April 26, 2023

To start, I will say that I think adding the licensing requirement for life was a positive change.

My main concern is removing the requirement for a legal opinion in Section VII of the Best Practices Procedures for IBT/Corporate Divisions.

The language contained in the Best Practices Procedures for IBT/Corporate Divisions related to guaranty association coverage involving property and casualty insurance assumes that each U.S. jurisdiction has laws that address the issue that we are concerned about….guaranty fund coverage not being reduced, eliminated, or otherwise changed as a result of the transaction.

The Drafting Note contained on page 5 acknowledges that the Receivership Law (E) Working Group is still working on this very issue. Assuming that the Working Group obtains consensus and recommends changes to the Property and Casualty Insurance Guaranty Association Model Act (#540), there are no assurances that states will actually adopt the changes. For this reason, it does not seem unreasonable to me in a best practices scenario, to suggest that interested parties obtain a legal opinion regarding guaranty fund protection for policyholders of restructured entities.

John F. Rehagen, CFE, ACI
Division Director
Missouri Department of Commerce & Insurance

Wayne Mehlman
Senior Counsel
(202) 624-2135
waynemehlman@acli.com

April 26, 2023

Elizabeth Kelleher Dwyer, Co-Chair
Glen Mulready, Co-Chair
Restructuring Mechanisms (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106

RE: Revised Draft of its *Best Practices Procedures for IBTs and Corporate Divisions*

Dear Superintendent Dwyer and Commissioner Mulready:

The American Council of Life Insurers (ACLI) appreciates this opportunity to comment on the Restructuring Mechanisms Working Group's revised draft of its *Best Practices Procedures for IBTs and Corporate Divisions*.

We would first like to thank the Working Group for developing this document since it will help regulators better understand the various procedures that need be followed as they review proposed IBT and corporate division transactions.

There are, however, several items that we'd like to bring to your attention.

(1) The page numbers in the Table of Contents will need to be renumbered due to language that was added to the revised draft.

(2) *Section V, Subsection 1 – Use of an Independent Expert* allows for an in-house Department expert to review a proposed corporate division transaction instead of an independent expert, though an independent expert is preferred. As we previously mentioned to this Working Group in our letter dated June 21, 2022, our *Principles on IBT and Corporate Division Legislation* state that independent experts must be utilized during the reviews of <u>both</u> IBT and corporate division transactions.

(3) In *Section VII – Analysis of Issues Affecting Policyholders, Claimant and other Stakeholders*, we suggest that Subsection 2.a. be deleted since policyholder consent is not required for IBT or corporate division transactions. Other requirements, including those for notice, public hearing, independent expert review (or in-house expert review for corporate divisions), robust regulatory review and court

approval (for IBTs) are designed to protect policyholders who are not otherwise able to consent to, or opt-out of, a proposed transaction.

(4) *Section IX, Subsection 1.a. – Guaranty Association Coverage* states:

Prior to approving a proposed restructuring transaction, a commissioner should make a factual determination regarding guaranty association coverage issues based on the criteria outlined below.

a. For restructuring transactions involving life, annuity or health insurance, the assuming or resulting insurer(s) should be licensed so that policyholders maintain eligibility for guaranty association coverage from the same guaranty association that would have provided coverage immediately prior to the restructuring transaction. This means that the assuming insurer or resulting insurer(s) must be licensed in all U.S. jurisdictions where the transferring or dividing insurer was licensed or had ever been licensed with respect to the policies being transferred or allocated in the transaction.

We strongly support this section of the revised draft and urge that it not be modified. It is very important from a life and health insurance guaranty association (G/A) coverage standpoint that a successor entity be licensed in the same state(s) where the original entity was licensed (or had ever been licensed) with respect to the policies being transferred or allocated, since each state requires an insurer to be licensed in its state in order for it to be a “member insurer” of its state’s G/A.

If a successor entity is placed into liquidation and its policyholders are not covered by the same state G/As as they were prior to a restructuring transaction, and instead receive “orphan” coverage through the successor entity’s domiciliary state G/A, it is possible that the domiciliary state G/A: (1) may not provide the same level of G/A coverage as the policyholders’ state G/As and/or (2) may not have enough assessment capacity to pay policyholders’ claims on a timely basis, either of which would harm policyowners.

It should be noted that the NAIC updated its *Life and Health Insurance Guaranty Association Model Act* many years ago to state that G/A coverage should generally be provided to policyholders by their resident state G/As, rather than by an insolvent insurer’s domiciliary state G/A. One reason for this was to prevent assessment capacity issues.

Given these concerns, and the importance of having a strong life and health insurance G/A safety net, we urge the Working Group to maintain the licensing requirement language that is in the revised draft.

Thanks again for this opportunity to provide comments. If you have any questions, feel free to contact me at waynemehlman@acli.com or 202-624-2135.

Sincerely,

Wayne A. Mehlman

Wayne Mehlman
Senior Counsel, Insurance Regulation

April 26, 2023

Superintendent Elizabeth Kelleher Dwyer
Chair, Restructuring Mechanisms Working Group
National Association of Insurance Commissioners

RE: Principles for Insurance Business Transfers (IBT) and Division Statutes

Dear Superintendent Dwyer:

The American Property Casualty Insurance Association (APCIA) appreciates the opportunity to provide comments on the draft *Principles for Insurance Business Transfer (IBT) and Division Statutes*.

As the Working Group is aware, there is a broad diversity of views on IBTs and division statutes within APCIA's membership, and APCIA has therefore generally refrained from either supporting or opposing such legislation when it is proposed in state legislatures. However, APCIA members have reached consensus on a set of guiding principles that should be reflected in any IBT, or division legislation considered. APCIA has previously shared those principles with the Working Group (and they are attached hereto for your reference). We are pleased that, with only one exception noted below, the Working Group's draft Principles document generally reflects APCIA's consensus principles, and in some cases has adopted language directly from those principles. We are grateful to the Working Group for the careful consideration it has given to our members' views.

One of our principles requires that any regulatory review of proposed IBT or division statutes must establish that the terms and impact of the transaction "do not have a *material* adverse impact on policyholders, reinsurers, or guaranty associations"(emphasis added). We note that the draft Principles document makes numerous references to regulatory consideration of potential adverse impacts but omits the word "material." A "no material adverse impact" standard is utilized in the UK's Part VII regime (on which existing U.S. IBT laws generally are based), as well as in various state laws, including for example, in Oklahoma where IBTs are successfully occurring. Omission of the word "material" could open the door to minor and relatively insignificant issues becoming an obstacle to an otherwise sound transaction. We therefore urge the Working Group to consider using the "material adverse impact" standard in the Principles document.

One of our members has also expressed concern that some of the language in the draft referring to parental guarantees might be used to require such guarantees where they are not needed and are unobtainable, thus preventing an otherwise sound transaction from even being reviewed. Not all insurers will necessarily have a parent company at all or may not have one that is capable of providing a financial guarantee. Many successful IBT transactions have occurred without a parental guarantee. While a parental guarantee might be useful in some circumstances, the lack of one need not necessarily be an insurmountable roadblock to *any* transaction that is otherwise fully reserved, conservative, and prudent. We urge the Working Group to ensure that the language of the draft provides regulators with clear and adequate flexibility on this point.

We appreciate the Working Group's past and continuing consideration of our views.

Sincerely,

Robert W. Woody

Robert W. Woody
Vice President & Counsel
APCIA

Principles for Insurance Business Transfers (IBT) and Division Statutes

Due Process

- Robust due process must be afforded to stakeholders impacted by a transaction (policyholders, reinsurers, guaranty associations). This should include:
    - Notice to stakeholders as determined by the regulator
    - Public hearing
    - Opportunity to submit written comments

Guaranty Fund Coverage

- No impacted policyholder should lose or gain guaranty fund protection as a result of a transaction.

Robust Regulatory Review Process

- The regulatory review must be robust and should, at a minimum, include the following findings:
    - The assets to be allocated to insurers involved in the transaction are adequate to cover the insurer's liabilities.
    - The impact and terms of the transaction do not have a material adverse impact on policyholders, reinsurers, or guaranty associations.
    - The review should consider the plans of any insurer involved in the transaction to liquidate another involved insurer, sell its assets, consolidate, merge, or make other changes, and the resulting impact on policyholders, reinsurers, and guaranty associations.

Independent Expert

- The regulatory review process for insurance business transfers will utilize an independent expert to advise and assist the regulator in reviewing proposed transactions (including advising on any material adverse impact on policyholders, reinsurers, or guaranty associations) and to provide any other assistance or advice the regulator may require.

Court Approval

- Court approval must be required for insurance business transfer transactions but not for divisions.

Carolyn W. Fahey
Executive Director
703-740-7527
E-Mail: cwfahey@airroc.org
Web: www.airroc.org

April 26, 2023

Superintendent Elizabeth Kelleher Dwyer,
Chair of the Restructuring Mechanisms (E) Working Group

Re: Best Practices Procedures for IBT/Corporate Divisions
Exposure Draft 4-4-23

Superintendent Dwyer and Members of the Restructuring Mechanisms (E) Working Group,

AIRROC is pleased to offer comments in response to the draft "Best Practices Procedures for IBT/Corporate Divisions". As a non-profit association AIRROC and its Board do not advocate for any specific position but provide resources and information. For that reason, AIRROC is not commenting on any specific aspects of the proposed best practices.

AIRROC is the only US based non-profit association focusing on the legacy sector of the insurance and reinsurance industries. Membership is on a corporate level and given the impact and importance of legacy business to the entire industry, AIRROC has attracted many talented and experienced participants that all have legacy or runoff business in their portfolio. The members include major US and international insurance and reinsurance companies, legacy acquirers, well-known rehabilitations, receiverships and liquidations, brokers, run-off managers and state insurance departments.

Because of our belief in the importance of clarity and discussion on the topic of runoff, AIRROC is requesting that the working group remove "Section X – Run-off Procedures" from the Best Practices Procedures for IBT/Corporate Divisions. We believe that the subject is distinct from the issues that this document is being developed to address, and that its inclusion confuses the distinct topics of restructuring and runoff. We would support the further discussion of runoff for inclusion in the white paper the committee is developing or in independent guidance as appropriate. We look forward to working with the members on identifying best practices around this important subject.

As referenced in the PwC Global Runoff Survey from 2022, the size of the global runoff market is $960 bn with $464 bn of those liabilities in North America. This is an increasingly important segment of the insurance market, and its management encompasses a broad range of insurers and activities. While this is an important indicator of the demand for more restructuring mechanisms within the insurance industry in recent years, it is important to note that these are distinct and separate issues.

Over the past two or more decades, the term “runoff” has been expanded to refer not only to the runoff of a particular contract, but also to entire books of business, to the insurance or reinsurance company itself and finally, to the entire sector of the market in which such business is administered. There have been many changes since the development of the 1997 Restructure White Paper, and before duplicating its analysis in a modern document it would be prudent to undertake a thorough discussion as to whether it remains relevant to today’s insurance industry.

How can runoff be defined? Runoff business is most widely defined as lines of business that are no longer written. The definition can vary widely by individual companies so this should be considered carefully. The definition of runoff can have different meanings based on situations.

Insurance and reinsurance companies voluntarily place lines of business into runoff for varying reasons: to discontinue a line of business for which they no longer have expertise or profitable experience, to re-focus their business strategy, to improve claims handling by transfer to those better equipped, and consequently improve their capital deployment. Also, as you are all aware, a state regulator can also put a company into receivership, insolvency or liquidation to protect the rights of policyholders, so the state appointed receiver administers the runoff. It is worth making the point that this “involuntary runoff” is very different from a “voluntary runoff” where there is a conscious decision by management to cease underwriting or dispose of a certain line of business as a strategic step. A “voluntary runoff” in these situations is in essence strategic portfolio management.

As the NAIC looks at the options and new states continue to adopt laws that create tools for restructuring, this is an opportunity to create a structure that can underpin the insurers in your state. Restructuring mechanisms provide the opportunity for insurers to grow and serve policyholders by giving them a way to change their operations to improve efficiency and let those that are experts in runoff take the helm.

In conclusion, AIRROC Is asking that the Restructuring Mechanisms (E) Working Group consider three main points:

1) Remove Section X from the draft “Best Practices Procedures for IBT/Corporate Divisions”.

2) Work with AIRROC and our member companies to conduct an updated analysis of the runoff sector in lieu of relying on a 1997 White Paper.

3) Consider adding this analysis to the in progress White Paper or in separate guidance.

AIRROC looks forward to a continued dialogue with the NAIC and more specifically the Restructuring Mechanisms (E) Working Group.

Respectfully Submitted,

Carolyn W. Fahey
Executive Director, AIRROC

cc: Robin Marcotte and Dave Daveline, NAIC

Comments of the Center for Economic Justice

To the NAIC Restructuring Mechanisms (E) Working Group

Regarding Draft "Best Practices for IBT/Insurer Divisions"

April 26, 2023

The Center for Economic Justice offers the following comments on April 4, 2023 exposure draft of "Best Practices for IBT/Insurer Divisions." Our comments focus on the need for a policyholder advocate in any IBT and Division transaction.

Overview and Rationale

The purpose of a policyholder advocate – or consumer advocate, generally – in regulatory proceedings is to ensure that consumer interests have an advocate with sufficient resources and expertise to engage substantively in the regulatory proceeding on behalf of consumers as a necessary counterweight to essentially unlimited resources available to the industry entities seeking a particular regulatory outcome.

The meetings of this working group provide a good example. Each meeting is well attended by numerous industry participants and their advocates and lobbyists. While CEJ has participated in a number of the working group's calls, there is clearly a massive disparity in resources between industry's and the sole consumer advocate's participation.

Now consider this experience at the state level where – with rare exceptions – there is no consumer advocate participating in any regulatory proceeding, let alone an IBT or division proceeding.

A few arguments have been offered in opposition to formalizing the designation and participation of a policyholder advocate in IBT or division proceedings. One argument is that affected policyholders can participate in the process through mechanisms set out in the communication plan. Assuming such participation even occurs, it is unclear how a consumer can meaningfully participate in proceeding marked by highly technical and legal issues with many key documents marked as confidential and unavailable to the consumer.

Such proposed individual consumer participation is analogous – but even less understandable to a consumer – than asking a consumer to participate in a review of an auto or long-term care insurance rate filing or a policy form filing. Absent the technical and legal expertise to address the criteria imposed on the regulator, consumer participation will almost certainly be limited to generalized concern or complaints which have little impact in an IBT or division proceeding.

In contrast, if the IBT or division proceeding required the appointment and participation of a policyholder advocate with adequate funding for such participation, policyholders would have a true advocate with the skills and resources to gather and understand consumer concerns as well as evaluate the proposed transaction from the viewpoint of the consumer.

CEJ knows firsthand the impact of the involvement of a consumer advocate in regulatory proceedings. CEJ routinely weighed on rate and form filings in Texas for various lines of insurance and, in most cases, the preliminary decision by the regulator or the proposal by the insurer was modified – changes that would not have occurred in the absence of a consumer advocate.

Another argument is that the Commissioner is charged with protecting consumers and, consequently, is the consumer's advocate. While insurance regulators are charged with consumer protection, that responsibility is not the same as serving as a consumer advocate in a proceeding in which the Commissioner must make a regulatory decision. If insurance commissioners were consumer advocates, there'd be no need for a consumer participation program at the NAIC or for public participation in regulatory proceedings. The fact that public participation is required for most regulatory proceedings – particularly those that directly impact certain consumers – is recognition that the regulator is not consumer advocate.

Another argument is the there is an expert hired by the Commissioner to evaluate the impact on consumers. In every IBT transaction, we've learned about, the independent expert is an actuary whose primary responsibility is to ensure the receiving entity is as financially strong and administratively competent as the insurer transferring the business. While actuaries have great expertise in certain areas, they don't have expertise in all areas related to consumer protection. Nor is the independent expert a consumer advocate. In all these proceedings the insurance entities are able to provide as much information and explanation and rationale as they want to the Commissioner and to the independent expert – there is no policyholder advocate to do the same for consumers or rebut industry assertions when so warranted.

For these reasons, CEJ urges the working group to include the appointment and funding of a policyholder advocate for both IBTs and divisions. A policyholder advocate is necessary for both types of transactions. With IBTs, the consumer is forced without consent to do business with an insurance company the consumer did not select. Consequently, there are policyholder issues that go beyond technical financial analysis or some assessment of administrative capability.

As with IBTs, an insurer engaging in a division is doing so because it provides significant financial benefits to the insurer. In any situation in which the proposed transaction is based on financial gain for the proposing insurer, there is a need for a policyholder advocate to ensure consumer concerns are identified and given consideration. In the case of divisions, it is vitally important that policyholders are not moved to a new entity with less financial strength. We recognize that regulators' main task is evaluating these transactions is just that type of financial analysis, but regulators sometimes miss things – in part due to representations made by the proposing insurer. One example would be some regulators' approval of lender-affiliated reinsurance transactions by private mortgage insurers leading up to the financial crisis. Some regulators saw these transactions as legitimate risk-spreading when, in fact, they represented the absence of risk management because they were kickbacks from the insurer to the lender to convince the lender to select the particular private mortgage insurer.

Specific Recommendations for the Document

Section II (1)(d)

Section II (1) sets out procedures for IBTs and divisions. The procedures are a list of information required of the applicants for the transaction. Section II(1)(d) states:

> The effect of the IBT on the transferring company's and assuming company's policyholders, (including with respect to guaranty association coverage), claimants and other stakeholders.

With the exception of this Section II (1)(d) and new language related to guaranty fund coverage impacts, all the information requested in this section about the IBT is financial information spelled in great detail. The fact that 12 of the information items are for financial information with only 1 item for non-financial information raises our concern that non-financial impacts and impacts not easily quantifiable will not be deemed important and reinforces the need and our proposal for a policyholder advocate in the proceeding.

We suggest Section II(1)(d) be expanded to itemize certain information that should be provided by changing the period at the end of the section to a comma and adding the following:

. . . including

- the assuming company's historical performance relative to the transferring company's performance serving policyholders and claimants, including
    - percentage of claims denied;
    - time to settle claims;
    - number of consumer-disputed claim settlements;
    - number and type of consumer complaints;
    - number of type of regulatory investigations and enforcement actions;
    - nature and effectiveness of routine policyholder communications
    - ability of policyholders to access information about the policies and company procedures; and
    - any other comparison of non-financial performance between the transferring assuming companies' historical performance relevant for assessing policyholder impact of the proposed transaction.

- the capability and performance of the assuming company's infrastructure and systems for communications with policyholders;

- the capability and performance of the assuming company's infrastructure and systems for claims settlement, including dispute resolution related track record of assuming company;

- the capability and performance of the assuming company's infrastructure and systems to assist policyholders to understand and use their policies;

- any changes in the nature of regulatory oversight of the assuming company from the transferring company and regulatory oversight of the transferred policies following the transaction;

- the quality and readability of the assuming company's templates for consumer notices and disclosures; and

- any other aspect of company non-financial performance potentially impacted by the transaction.

<u>Section II (2) (e)</u>

Section II (2) provides a list of information required of the insurer proposing a corporate division and item II (2)(e) is the sole item requiring information about policyholder impact. Item II (2) (k) adds a set of questions about the future marketing and products which is important information, but does not address impact on current policyholders. We suggest expanding item II(2)(e) along the lines of our proposed expansion of item II(1)(d), above.

Provisions for adding a policyholder advocate

In section III (1), add "Appointment and Report of Policyholder Advocate."

In section III (2) add "Appointment and Report of Policyholder Advocate."

In section IV (2) High Level of Confidence, add a paragraph (c):

(c) Appoint and provide sufficient funding for a policyholder advocate to

i. represent and advocate on behalf of policyholders in the proceeding;
ii. review all documents, whether deemed confidential or not, submitted or prepared in connection with the proposed transaction;
iii. submit requests for information to the proposing companies to the extent the requested information is relevant for assessing the consumer impacts of the proposed transaction;
iv. offer recommendations for effective communication with affected policyholders and other stakeholders;
v. obtain comments and feedback from affected policyholders regarding the proposed transaction;
vi. provide a report with a recommendation for the Commissioner to approve or disapprove the proposed transaction with the rationale for the recommendation and communicate that report to the Commissioner, proposing insurers, affected policyholders and other stakeholders. The full report provided to the Commissioner and proposing insurers may contain confidential information if necessary for supporting the recommendation. A report provided to any other persons, including affected policyholders, must redact confidential information; and
vii. participate in regulatory and legal proceedings and meetings regarding the proposed transaction

Add a new section: Appointment of the Policyholder Advocate

a. The appointment and funding of a policyholder advocate to provide substantive representation and advocacy in the proceeding is essential to ensure consumer interests are adequately represented.

b. The Commissioner will appoint a policyholder advocate with demonstrated experience and skills to:
   i. Effectively represent consumers;
   ii. Provide the necessary technical and non-technical analysis;
   iii. Effectively communicate with parties to the transaction;
   iv. Coordinate and utilize experts as needed; and
   v. Contribute value to the proceeding.

c. In appointing the policyholder advocate, the Commissioner shall not appoint a person with a material conflict of interest that might compromise the advocate's ability or willingness to adequately represent consumers. In considering persons for appointment as policyholder advocate, the Commissioner shall solicit recommendations from consumer organizations within and outside the state.

d. The Commissioner shall appoint the policyholder advocate as soon as practical following receipt of the transaction application, but no later than 21 days after receipt of the transaction application.

e. The Commissioner shall direct the proposing companies to provide funding for the policyholder advocate within 7 days of the Commissioner's appointment of the policy advocate in amount of the greater of $50,000 or 0.01% of the total value of the liabilities in the transaction. The $50,000 minimum should be increased annually by the annual change in the Consumer Price Index starting in 2024.

f. The Commissioner shall audit the expenditures of the policyholder advocate and the appointment of the policyholder advocate shall be conditioned upon the advocate taking personal responsibility for any misuse of funds.

g. (See earlier comments for specific tasks and responsibilities of the policyholder advocate)

Please see our comments above regarding the policyholder advocate's role in the communication plan with stakeholders.

Thank you for your consideration of our comments.

ENSTAR (US) Inc.

Comments to Restructuring Mechanisms (E) Working Group – April 26, 2023

Dear Superintendent Elizabeth Kelleher Dwyer:

Thank you to the working group members and NAIC staff for the continued work and discussion relating to the *Best Practices Procedures for IBT/Corporate Divisions* ("Best Practices"). Enstar provided comments on the Best Practices during its last exposure period, and we continue to believe that regulatory best practices should be founded in the legislation that states are enacting to enable insurance business transfers ("IBT") and corporate divisions. The Best Practices diverge from statutory requirements and purposes in several notable areas, including the development of pro-forma financial statements, the creation of new policyholder rights, and the necessity and method of obtaining policyholder consent, which we addressed in our prior letter and reaffirm without repeating here.

With the increasing interest in restructuring mechanisms and the few states that have passed enabling legislation at this time, it is likely that regulators will be asked to review or even participate in the oversight of restructuring transactions without similar legislation in their own states, which is especially applicable to IBT. We believe that it is important for regulators in this position who may seek out the work of this working group to provide guidance for their review have a clear understanding of why elements of the Best Practices differ from existing state law and similar NAIC frameworks. For example, the NAIC Form A model regulation requires three-year financial projections, and the NCOIL IBT Model Act requires three years of pro-forma financials, with all states with similar acts requiring the same or an unspecified amount. However, the Best Practices recommend five years of pro-formas, without addressing a reason for the difference from existing laws and models. For this and other similar changes to already established review standards, we would appreciate that the working group provide context for the differences. In doing so, the working group can help insurers and states with existing laws from being placed into a position of trying to explain why their standards and this document are not in alignment, when those standards are what came first and are the basis of the creation of the Best Practices.

411 Fifth Avenue, 5th Floor
New York, NY 10016
Tel: (212) 790-9700 Fax: (212) 790-9800

We also would encourage the reconsideration of *Section X – Run-off Procedures* in this document. IBT and division transactions may or may not result in runoff, and runoff can be created and exist without a restructuring transfer occurring. Runoff is frequently managed voluntarily, without negative solvency implications. Court-authorized transfers for insolvent companies (similar to the IBT framework) have occurred in states without IBT legislation under the authority of the receivership court. However, these types of transfers are not addressed by the Best Practices, and as such this section on involuntary runoff seems out of place in a discussion of voluntary, solvent restructuring transactions. We believe this section would be best suited for a separate document, and we would appreciate additional discussion of the purpose and objectives of this section should it remain a part of the Best Practices.

Sincerely,

Robert Redpath
Senior Vice President
Regulatory & Technical Director

James Mills
Vice President
Legal Counsel

ENSTAR 35

Milliman

201 Edgewater Drive, Suite 289
Wakefield, MA 01880-6215
USA

Tel +1 781 213.6200
Fax +1 781 213.6201

milliman.com

April 26, 2023

Superintendent Elizabeth Kelleher Dwyer
Chair of the Restructuring Mechanisms (E) Working Group

RE: Best Practices Procedures for IBT/Corporate Divisions

Dear Ms. Dwyer:

Below are comments that I have for Best Practices Procedures for IBT/Corporate Divisions. I appreciate the opportunity to submit these to the Restructuring Mechanisms (E) Working Group.

Page 5 – n. ii. 2nd line - delete duplicate that

Page 9 – 2. High Level of Confidence – Per comments below, I would recommend deleting this section and incorporating relevant areas into the prior section.

Page 9 – 2. 1st line - establish, at a high level of confidence -

Part VII guidance, for example, does not say anything about levels of confidence and it does not ask the IE to "establish" anything, rather give their opinion. Rather, the guidance says that the IE should give their "opinion of the likely effects of the scheme…" and "analyse and conclude on how groups of policyholders are affected differently by the scheme, and whether such effects are material in the independent expert's opinion. Where the independent expert considers such effects to be material, they should explain how this affects their overall opinion."

Page 9 –2. 2nd line – no adverse effects - suggest adding "material"

Page 10 – b. iii 1st line – adverse impact – suggest "material adverse effect"

Page 10 – 3. a. 1st line - Prescribed conservative assumptions - These should be defined, and as to why they need to be conservative.

Page 11 – 4. 1st line - Assessment of risk capital - It seems unclear as to the situations where no additional capital can be accessed.

Page 11 – 4. a. 1st line - before some add ", under"

Page 11 – 4. b. iv. 1st line - after capital remove comma

Page 12 – 5. a. 2nd line - add space after the

Page 12 – Section V 1st line – after an add Independent

Page 12 – d. 2nd line - to establish at a high level of confidence that policyholders and other key stakeholders experience no adverse effects – same comments as earlier

Page 12 – e. 4th line - a neutral or better condition – suggest replacing with not materially adverse impacted

Page 12 – e. 9th line - remove space after change

Page 13 – f. 2nd line - add space after to

Page 14 – 3rd line - put the policyholders and other key stakeholders in the same or better position - create no material adverse effect on ....

Page 14 – 1. a. 1st line - “ground up” - What is this intended to mean? I think it should be clarified that independent actuarial tests are not required but could be performed if needed.

Page 14 – 1. a. iii. 1st line - “insurer’s – clarify which insurer(s)

Page 14 – 2. a. 2nd line - in the same or better condition – suggest replacing with not materially adverse effected by

Page 20 – Drafting Note: 2nd line - delete to

Page 23 – Independent Consultant – 4th line - within the past twenty-four (24) months - This time frame seems onerous. You could also ensure that the expert has the time and capacity to undertake the work.

Page 23 – Independent Consultant – 6th line - add space after this

Regards,

Stephen R. Di Censo

Stephen R. DiCenso, FCAS, MAAA

cc: Robin Marcotte, NAIC
Wendy Jacks, NAIC
Dan Daveline, NAIC

I:\Best Practices ED 4-4-23_SRD Comments

BY E-MAIL

April 26, 2023

Director Dwyer
Commissioner Mulready
Co-Chairs, NAIC Restructuring Mechanisms (E) Working Group ("Working Group")

Attention: Robin Marcotte (rmarcotte@naic.org)

Re: Comments on Working Group's Re-Exposure of Best Practices

The undersigned companies welcome the opportunity to comment on the revised Best Practices document re-exposed by the Working Group. We appreciate the thought and time that the Working Group members have devoted to refining the exposure, and, overall**, believe that the Best Practices document provides a strong foundation for ensuring appropriate solvency and consumer protections will apply to Insurance Business Transfer ("IBT") and Corporate Division ("CD)" (collectively, "IBT/CD") transactions.**

Use of Independent Expert

In prior comment letters, the undersigned companies have maintained that we strongly believe that every IBT/CD should require an independent expert ("IE") report, and that the IE report should be publicly available. We note that the Best Practices require IE reports for IBTs; we welcome and appreciate this position. After working with the Working Group, we believe that the Best Practices document strikes an appropriate balance in the use of IEs for CD transactions. We further believe it would be appropriate for any report generated by an in-house department of insurance also be made public in order to allow interested policyholders and stakeholders to participate in a public hearing on the CD.

Guaranty Associations

We reiterate our support for Section IX(1)(a) of the NAIC Best Practices Procedures for IBT/Corporate Divisions. This section requires that for restructuring transactions involving life, annuity or health insurance, the assuming or resulting insurer(s) should be licensed in each state where the transferor or predecessor insurer(s) are licensed so that policyholders maintain eligibility for guaranty association coverage from the same guaranty association that would have provided coverage immediately prior to the restructuring transaction. It is important from a Life and Health Guaranty Association coverage standpoint that the successor entity be licensed and regulated in a similar fashion. The NAIC Life & Health GA Model Act requires that an insurer be licensed (or formerly licensed) in a state to be considered a member of that state's guaranty association.

If the policyowners are not covered by the same guaranty association as they were prior to the restructuring transaction (and instead receive coverage via the insurer's domestic guaranty association), the domestic guaranty association may not have the necessary assessment capacity to pay claims on a timely basis, nor offer the same level of guaranty association coverage as the previous guaranty association, further harming policyowners. Given these concerns, and the importance of maintaining a strong guaranty association safety net, we urge the Working Group to include the licensing requirement in its Best Practices document. In addition, we recommend an accreditation requirement that policyowners must have coverage under the same guaranty association both before and after the transaction, which will require licensing of the acquiring insurer in each of the jurisdictions where customers of the existing insurer reside.

***

We appreciate the efforts of the Working Group in getting to this point. Once the Best Practices document has been finalized, we urge the Working Group to take the appropriate steps so that its requirements become accreditation standards. A robust accreditation system has proven over time as the most effective tool to promote consistent and strong solvency regulation. We believe establishing the Best Practices as an accreditation standard is the best way to protect against the potentially significant adverse consequences from these transactions.

Sincerely,

Douglas A. Wheeler
Senior Vice President, Office of Governmental Affairs
New York Life Insurance Company

Kevin L. Howard
Vice President, Deputy General Counsel & Head of Government Affairs
Western & Southern Financial Group

Andrew T. Vedder
Vice President – Enterprise Risk Management
The Northwestern Mutual Life Insurance Company

Northwestern Mutual , New York Life and Western and Southern Joint response to requested Wording

No Monolines

In Section IV.2, we would propose to insert the following language:

c. The Domestic Regulator should ensure that neither the transferor nor transferee will be a monoline company following the transaction. In making this determination, the Domestic Regulator or Independent Expert, as appropriate, should determine that, following the transaction:

i. Neither the transferor nor transferee will have 90% or more of its reserves in the same line of business; and

ii. Both the transferor and transferee will have diversification across lines of business. In making this determination, the Domestic Regulator or Independent Expert should consider whether company is operating in a single industry segment, is offering differentiated types of insurance products, or is otherwise exposed to increased risk because of its insurable risk profile.

No Worse Off

In Section II.1 and II.2, we would propose to insert the following language as items (o)-(p) and (m)-(n) respectively:

o./m.: Update to the Own Risk and Solvency Assessment reports (“ORSA”) demonstrating how the proposed transaction would impact the ORSA analysis for the dividing or transferring insurer as well as for any insurer that will be assuming policy liabilities if the proposed transaction is approved.

p./n.: Documentation of how the administration of policies by the dividing or transferring insurer following the transaction will provide a continuing level and quality of service.

In Section IV.3, we would propose to insert the following language:

e. The financial ratings for all companies involved in the transaction should have at least the same financial rating as the company transferring the policy liabilities. This should apply for all new companies as well as the ongoing rating for the transferring or dividing company.

In Section IV.4.b, we would propose the following language to address how to assess from an actuarial perspective whether insureds are “no worse off”, regardless of whether it is an IBT or a CD:

b. ~~For IBTs or other transactions which will not have access to additional capital,~~ An actuarial report of the adequacy of ~~run-off~~ reserves (gross and net) being transferred should include an analysis of . . .

JOINT SUBMISSION OF NOLHGA AND NCIGF
TO NAIC'S RESTRUCTURING MECHANISMS WORKING GROUP
REGARDING THE RESTRUCTURING MECHANISMS BEST PRACTICES EXPOSURE DRAFT

April 26, 2023

The National Organization of Life & Health Insurance Guaranty Associations ("NOLHGA") and the National Conference of Insurance Guaranty Funds ("NCIGF") are writing to comment on the Restructuring Mechanisms Working Group's (the "Working Group") April 4, 2023 draft of its Best Practices Procedures for IBT/Corporate Divisions (the "Current Exposure").[1] NOLHGA and NCIGF appreciate the Working Group and NAIC staff's efforts to incorporate technical changes related to guaranty association/fund coverage. Representatives of both organizations worked closely with NAIC staff on the Current Exposure and are in full support of the Working Group's adoption of the language related to guaranty association/fund coverage.

As has been the case throughout the NAIC's drafting process of the Best Practices and the White Paper, our comments generally focus on the concept (recognized by the Restructuring Mechanisms Working Group in both documents) that the policyholder protection of guaranty system coverage should not be reduced, eliminated or otherwise changed as a result of a restructuring transaction. The changes in the Current Exposure set forth the specific standards that must be satisfied to ensure that guaranty association/fund protection a policyholder would have had prior to a restructuring transaction is preserved when a restructuring transaction is consummated. Those standards differ depending on the lines of insurance involved in a proposed insurance business transfer or corporate division, and those differences are reflected in the Current Exposure. The Current Exposure contemplates that an applicant will present evidence of how those standards are satisfied in a proposed restructuring transaction, and the commissioner reviewing a proposed restructuring transaction will make the factual determination regarding whether those standards have been satisfied.

NOLHGA and NCIGF are prepared to continue this dialogue and to work closely with the Working Group as the Current Exposure is finalized. Thank you for the opportunity to share our perspective on the Current Exposure, and we look forward to working with you as this project moves forward.

Contact Information

National Organization of Life and Health Insurance Guaranty Associations
13873 Park Center Road, Suite 505
Herndon, VA 20171
Phone: 703.481.5206

Peter G. Gallanis
President
E-Mail: pgallanis@nolhga.com

National Conference of Insurance Guaranty Funds
300 North Meridian, Suite 1020
Indianapolis, IN 46204
Phone: 317.464.8176

Roger H. Schmelzer
President
E-Mail: rschmelzer@ncigf.org

[1] In response to questions and discussion at the end of the last meeting of the Working Group, NOLHGA will be submitting a separate comment letter to clarify and confirm its position on preserving guaranty association coverage in restructuring transactions involving life, annuity and health insurance lines of business.

April 26, 2023

Superintendent Elizabeth Kelleher Dwyer, Co-Chair
Commissioner Glen Mulready, Co-Chair
Restructuring Mechanisms (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106

Re: Exposure of Best Practices Procedures for IBT/Corporate Divisions ("Best Practices Document")

Dear Co-Chairs Dwyer and Mulready:

This letter is being submitted on behalf of the National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") to express its support for the portions of the Best Practices Document seeking to ensure the preservation of life and health guaranty association ("L&H GA") coverage for policyholders whose company is involved in an IBT or corporate division transaction ("Restructuring Transaction").

For the reasons stated in NOLHGA's comment letter of May 27, 2022 to the Receivership and Insolvency Task Force (copy enclosed), we believe the only effective way to preserve L&H GA Coverage in Restructuring Transactions is to require the successor entity in the transaction to be licensed in all states where the predecessor entity was ever licensed with respect to life, annuity and health policies being transferred in the transaction.

This approach will not only ensure that a successor entity's inherited life, annuity and health policies remain eligible for coverage by the L&H GAs in those states, but also will ensure that the successor entity is subject to regulatory oversight in each of those states for the benefit of the policyholders in those states. This continuing regulatory oversight is particularly important for life, annuity and health personal lines of business since most of these products (e.g., life insurance, annuities, LTC and disability insurance) represent long term obligations by an insurer to provide essential financial security protection to individual consumers.

We want to express our appreciation to the Working Group for its efforts on the Best Practices Document, and for allowing us the opportunity to provide input and comments on the document. We look forward to discussing these matters with you on the next call of the Working Group.

Very truly yours,

Peter G. Gallanis
President

National Organization of Life and Health Insurance Guaranty Associations
13873 Park Center Road, Suite 329 | Herndon, VA 20171
Phone: 703.481.5206 | Fax: 703.481.5209
www.nolhga.com

May 27, 2022

Jane M. Koenigsman, FLMI
Sr. Manager II, L&H Financial Analysis
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106

Re: Request for NAIC Model Law Development for the P&C Insurance Guaranty Association Model Act

Dear Ms. Koenigsman:

This letter is submitted with respect to the Receivership and Insolvency Task Force's recent exposure of a "Request for NAIC Model Law Development" ("MLD") relating to the Property & Casualty Insurance Guaranty Association Model Act (the "P&C Model Act"). We understand that the MLD's sole purpose is to propose changes to the P&C Model Act tailored to ensure that P&C guaranty fund coverage is not lost, expanded, or otherwise affected by corporate division ("CD") or insurance business transfer ("IBT") transactions (collectively, "Restructuring Transactions"). Given that the MLD is solely focused on P&C GA coverage, NOLHGA has no position on the MLD but rather will defer to the views of those with expertise in P&C guaranty funds (e.g., the NCIGF and its members).[1]

NOLHGA, however, would like to address comments submitted in response to the MLD that suggested consideration also should be given to amending the Life and Health Insurance Guaranty Association Model Act ("L&H GA Model Act"). In particular, one of the comments suggested that the L&H GA Model Act should be amended to deem successor entities in Restructuring Transactions, irrespective of their licensing status, to be member insurers of the life and health guaranty associations (L&H GA).

For the reasons that will be discussed further below, NOLHGA would reiterate its view that successor entities in Restructuring Transactions involving life and health policies should be licensed in all states where the predecessor entity was ever licensed with respect to the policies being transferred. This not only will ensure that the successor entity's inherited life and health policies will remain eligible for coverage by the L&H GAs in those states, but it also will ensure that the successor entity is subject to regulatory oversight in each of those states for the benefit of each state's insurance consumers. As reflected in the draft Restructuring Mechanisms White Paper[2], requiring licensing of a successor entity where it inherits business could be important to ensuring ongoing regulatory control over the entity and avoiding potential harm to insurance consumers.

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[1] As previously noted, NOLHGA also does not have a position on whether states should adopt laws authorizing Restructuring Transactions. That is, NOLHGA neither supports nor opposes such laws but rather is focused on the potential implications of Restructuring Transactions to its member life and health insurance guaranty associations, and the protection its members provide to insurance consumers when their insurance company is placed in liquidation.

[2] The above reference, and similar references to "White Paper" in this letter, refer to the draft Restructuring Mechanisms White Paper, dated March 28, 2022, that was created by the Restructuring Mechanisms (E) Working Group of Financial Condition (E) Committee.

Most Life and Health Products Evidence Long-Term Policyholder Obligations

Virtually all life and annuity products, and many health products, represent long-term obligations by an insurer to provide essential financial security protection to its policyholders.[3] Consumers who buy these products have an expectation that their insurer will provide this protection for decades into the future, or even for a lifetime (or longer, in the case of some annuities). This long-term commitment of life and health insurers is extremely important to policyholders since, as they age and/or experience health problems, they will find it increasingly difficult, if not impossible, to obtain similar coverage on comparable terms.

The nature of life and health products is quite different from most property and casualty products. Property and casualty products typically provide coverage on an annually renewable basis. This permits property and casualty policyholders to go back into the marketplace to seek replacement coverage if they become dissatisfied with their insurer's performance or the terms of their policy, or if their insurance company fails. In addition, property and casualty coverage typically does not become prohibitively expensive or completely unavailable to consumers because of advancing age or developing health conditions. As a result, property and casualty policyholders should have the ability to non-renew their coverage and obtain comparable replacement coverage if they became dissatisfied with the insurer that takes over their policy in a Restructuring Transaction. Importantly, many life and health insurance policyholders would not have that option, for the reasons stated above.

L&H GAs have Long-Term Obligations to Continue Coverage for Policyholders

Given the long-term nature of many life, annuity, and health insurance policy obligations, and the difficulty consumers may experience in replacing this coverage, L&H GAs have explicit statutory obligations to continue coverage for policyholders of insolvent insurers. This statutory duty to continue coverage often results in L&H GAs having obligations that continue for many years into the future. As an example, L&H GAs affected by the Penn Treaty/ANIC insolvencies have obligations for covering long term care policies that are projected to continue for the next 30 years or more.

There are Important Policy Reasons Member Insurers of L&H GAs Should be Licensed

Given the long-term nature of L&H GA Coverage obligations, and concerns about the risks to L&H GAs of backstopping the obligations of insurers that are not subject to regulation, the L&H Model Act has provided from its inception that insurers must be licensed to be members of a state's L&H GA.[4] In effect, the licensing requirement ensures a level, regulatory playing field among insurers that will be eligible to have their products covered by the L&H GA. In this way, the L&H GA Model Act is designed

[3] Certain forms of health insurance, which are renewed on an annual basis, are exceptions to this statement (e.g., most forms of conventional medical insurance issued today). However, other forms of health insurance (e.g., individual long term care insurance and disability income insurance) are guaranteed renewable for the life of the policyholder and therefore do represent long-term obligations to policyholders.

[4] "Member Insurer" was defined in § 5(7) of the 1970 Model to include any person authorized to transact in this state any kind of insurance to which this Act applies under Section 3. **1971-4 NAIC Proc. 157, 162 (Dec. 14, 1970).** "Authorized" was changed to "licensed" in this definition as part of the 1975 revisions. **1976-4 NAIC Proc. 296, 300 (Dec. 9, 1975)**. The commentary notes that this change was intended to ensure that all unauthorized insurers are excluded from the Act. **1976-4 NAIC Proc. 296, 299 (Dec. 9, 1975)**. The 1975 version of the Model also included a comment at the end of section entitled Scope, which included the following language: "Furthermore, it [this Model Act] applies only to direct insurance issued by persons licensed to transact insurance in this state at any time. Coverage issued by insurers which have not submitted to the application of a state's regulatory safeguards is excluded from protection by this act".

to protect L&H GAs (and their member insurers) from being generally responsible for the insurance obligations of entities that are not subject to state licensing and regulatory requirements.

In 1985, the L&H Model Act was amended to provide that the definition of "member insurer" includes insurers whose license or certificate of authority in this State may have been suspended, revoked, not renewed, or voluntarily withdrawn. This language was not intended to create a general exception to the requirement that insurers should be licensed to be members of the L&H GA, but rather was intended to avoid having policyholders become ineligible for GA coverage due to a state regulatory action.[5] In many cases, financially troubled insurers will have their licenses suspended or revoked even before they are placed in receivership. The 1985 revision to the definition of member insurer was intended to avoid policyholders losing eligibility for GA coverage in those kinds of circumstances.

Concerns with Deeming Non-Licensed Successor Entities to be Member Insurers
As noted in the draft Restructuring Mechanisms White Paper, there is a fundamental regulatory interest in ensuring the licensing status of successor entities in Restructuring Transactions. If a successor entity to a Restructuring Transaction operates without a license in a state, it could result in a lack of regulatory knowledge and control regarding the company's ongoing operations in that state, which in turn could make harm to consumers more likely. This harm potentially could encompass all aspects of state insurance regulation.

These potential harms also could expose L&H GAs to increased risks if successor entities in Restructuring Transactions are deemed member insurers of the GAs without being licensed and subject to regulation in the GAs' home states. These risks could increase, based on the structure and the nature of the business that is the subject of the Restructuring Transaction. As an example, if the successor company is a newly formed or limited purpose entity running off risky forms of business (e.g., long term care policies), there could be substantial increased risk to a GA from such an entity not being licensed and regulated in the GA's home state. This is exactly the type of situation that the drafters of the L&H Model Act sought to prevent by generally requiring member insurers to be licensed entities.

There is an additional concern with unlicensed, successor companies being deemed member insurers of the L&H GAs. This concern relates to Section 11.B of the L&H GA Model Act, which empowers the Commissioner to suspend or revoke the license of a member insurer that fails to timely pay its guaranty association assessments. This provision is commonly viewed as a practical and effective way to ensure that member insurers timely pay their L&H GA assessments. In the event successor companies are deemed to be member insurers without being licensed, the power of a commissioner to enforce the payment of assessments by those insurers by revoking their licenses would not be available.

In addition to the above concerns, NOLHGA believes that obtaining amendments to all 51 L&H GA Acts to include unlicensed entities as member insurers may not be a practical or realistic solution. While the Life and Health GA System has been quite successful over the years working with regulators and legislators to update state GA Acts to be consistent with the Model Act, those results have only been

[5] As reflected in the NAIC Proceedings, the industry proponents of the 1985 amendments to the definition of "member insurer" provided the following explanation for those changes: "To emphasize the importance of what should be the clear dependence of coverage under the act on adequate regulation for solvency and competitive equality, the term "member insurer" has been modified and used to link more clearly the sections of the act relating to purpose, coverage, powers and duties, and assessments. Thus, the definition of member insurer has been expanded to include entities whose license may have been suspended or revoked. Insureds should not lose guaranty association coverage because of enforcement actions against an insurer under the laws and regulations designed to assure solvency, proper market conduct and competitive equality that all member insurers must adhere to. Equally, insurers should not be expected to extend coverage to entities that are not required to adhere to the same laws and regulations." **1984-2 NAIC Proc. 440, 462 (June 3, 1984).**

possible because of the widespread support of state regulators and industry members for various Model Act improvements. Given the fundamental change and potential increased risks of deeming unlicensed insurers to be L&H GA members, amendments to achieve that purpose could be considered controversial and difficult to accomplish in many states.

The Draft White Paper's Recommendation for a Possible Solution to Licensing Issues
NOLHGA sees some promise in the draft White Paper's recommendation for a possible solution to addressing licensing issues in Restructuring Transactions. That recommendation, which appears on the last page of the draft White Paper, is to have the appropriate NAIC working group consider whether changes should be made to the licensing process for companies resulting from Restructuring Transactions of runoff blocks. In that regard, the draft White Paper notes, "A streamlined process that still ensures appropriate regulatory oversight (and any licensure necessary to preserve guaranty association coverage) may be appropriate in limited circumstances."

As noted above, the draft White Paper recognizes that the failure of a successor entity to be licensed in relevant states could result not only in the loss of L&H GA coverage, but also in a lack of regulatory knowledge and control regarding the company's ongoing operations, which in turn could result in harm to insurance consumers. This risk to consumers, by itself, would seem to be of sufficient concern to justify the NAIC's consideration of an alternative licensing process for successor entities in Restructuring Transactions.

Very truly yours,

Peter G. Gallanis
President

NORTON ROSE FULBRIGHT

April 26, 2023

Norton Rose Fulbright US LLP
1301 Avenue of the Americas
New York, New York 10019-6022
United States of America

Direct line +1 212 318 3335
robert.romano@nortonrosefulbright.com

Tel +1 212 318 3000
Fax +1 212 318 3400

Superintendent Elizabeth Kelleher Dwyer,
Chair of the Restructuring Mechanisms
(E) Working Group,
National Association of Insurance Commissioners

Re: Comments to Best Practices Procedures for IBT/Corporate Divisions, Exposure draft 4-4-23

Dear Superintendent Dwyer:

We thank the NAIC Restructuring Mechanisms Working Group (the "Working Group") for the opportunity to comment upon the draft Best Practices Procedures for IBT/Corporate Divisions, exposure draft 4-4-23 (the "Draft"). Our comments below should be considered in the context of our prior comments (the "ProTucket Letter"), copy attached, to the draft White Paper, then dated October 22, 2021 (the "White Paper"), relating to Insurance Business Transfers ("IBTs") and Corporate Divisions ("CDs") which we submitted on behalf of our client, ProTucket Insurance Company ("ProTucket"). We and ProTucket also submitted comments to a prior version of the Draft. We once again submit comments on behalf of that client.

Our comments are organized as follows: I. General Comments to the form and scope of the Draft; II. Comments of Substance addressing specific issues of substance raised in the Draft; and III. Miscellaneous Comments addressing organizational and other miscellaneous drafting issues.

I. <u>General Comments.</u>

The Draft appears to be a combination of text from varied source documents, including the 1997 White Paper on restructurings, the Illinois Corporate Division statute, the Rhode Island IBT law, United Kingdom Part VII practices and commentary from some market participants. These documents in many cases contain similar guidance expressed in different terms and sometimes contradict one another. It appears that the Draft was not intended to be a fully integrated, internally consistent, document, and we cannot tell whether commentators should be reviewing the Draft as a "concept piece" to raise issues for further discussion or as guidance to be published for the use of examining regulators as implied in its title, "Best Practices Procedures for IBT/Corporate Divisions."

If the Draft is intended as guidance for use by regulators, we fear that the duplication and excessive prescriptive provisions in the Draft, sometimes set forth in exacting detail, will place an onerous and excessively time-consuming burden on examiners and applicants. Even if the Draft is intended to merely suggest standards for review, examiners will be tempted to follow its guidance with rigor, especially in light of the novelty of the subject matter. If it is intended as guidance to regulators, we recommend that the Working Group seriously consider a different format and an approach that reduces duplications and moderates some of the more onerous provisions of the Draft. Some of the provisions that we suggest be reworked or deleted are set forth in Sections II and III below.

As an over-all general comment, we recommend that the Draft be revised to speak in one voice and to reconcile the similar points made in different sections. Without such a re-draft it is difficult to provide definitive comments, and we would suggest that commentators be given opportunities to comment further once the Working Group clarifies how it proposes to use the Draft.

The Working Group may have its own preferences, but we recommend that it consider drafting guidance that would use a pre-existing format already familiar to regulators -- to which the IBT and CD issues can be added -- rather than creating an altogether new format. Specifically, we suggest that the Working Group use the Form A format as a framework into which IBT and CD issues can be added.

II. Comments of Substance.

Beyond these general comments, we note the points of substance set forth below.

1. Definition of IBTs. (Page 1.) Just as in the case of CD's, IBT's will almost always involve a transfer of obligations and assets. The first sentence of the Draft should be amended accordingly.

2. Scope and Timing of Guidance. (Page 1.) The Draft indicates that it is not intended to provide guidance as a model law or regulation. We recommend that the Working Group consider the scope of guidance to be provided – and whether it should be issued, for example, as optional or mandatory addition to the Financial Analysis Handbook

3. Projections. (Page 5 et seq.) The Draft would request 5 years of financial pro-formas or projections (for example, Section II (1)(i).) Although some states may at times request 5, instead of 3, years, the term for projections in Form A and license applications is usually 3 years. We recommend that 3 years be used as the standard.

4. Guaranty Funds. (Page 5 et seq.) The Draft addresses guaranty fund issues for life and non-life separately (for example, Section II (1)(n)(i) and (ii)). It appears that the intention behind the different text for these lines is the same, yet the provisions are worded differently. As these issues are still under consideration by the relevant NAIC committees and interested parties, we suggest that the language describing the due diligence needed to assure post-transfer guaranty fund coverage be general to accommodate changing legislation.

5. Parental Guarantee. (Page 8.) The Draft (Section II (4)(b)) implies that an IBT or CD "should provide for a commitment of parental and other… support". Requiring such support can effectively subvert the purpose of IBTs and CDs. Although there may be circumstances under which regulators may seek some level of external support for an IBT or CD, we recommend that this should not be generally required for such plans.

NORTON ROSE FULBRIGHT

6. Licenses. (Page 8.) The Draft (Section II (5)(a)) implies that the resulting insurer in an IBT or CD should have licenses "in all jurisdictions in which it [the predecessor insurer] wrote business." We recommend that that text be deleted. It should be sufficient that the insurer "will be licensed in all jurisdictions where required to take on business as a result of the restructuring." This text should also be understood to include circumstances where the transaction is structured to carve out those jurisdictions where the license, surplus line eligibility or other similar status is unnecessary to effect the transfer. For example, it should be sufficient to post collateral to support reinsurance credit as a substitute for a license.

7. Adverse Impact Standard. (Page 10 et seq.) The Draft refers to a number of standards to evaluate the impact of IBTs or CDs on stakeholders. Section IV (2)(b)(iii) requires that the transaction not have "any adverse impact". Section VI (preamble) requires that "policyholders and key stakeholders" be "in the same or better position" after the transfer. Section V (1)(d) calls for "no adverse effects". Section V (1)(e) requires that such participants be in "a neutral or better condition after" the transfer.

   Such standards could be onerous and impractical for a number of reasons. In a transfer between two highly creditworthy parties, it would make little sense to object to a transfer from a $12 Billion company equity to a company with $10 Billion, both with the same high credit rating. When evaluating the impact on both the transferor and transferee, it would very difficult to maintain that both parties would be in precisely the same position before and after a transfer. Furthermore, it would depart from normal practice to require regulators to regulate to a zero level of risk.

   Accordingly, we recommend that the Draft adopt a standard of "material adverse effect". This standard is very frequently used in commercial contracts and indeed in NAIC guidance and insurance laws.

8. RBC. (Page 10 et seq.) The Draft refers to Risk Based Capital (RBC) on numerous occasions. As discussed in the ProTucket Letter, RBC can often be an imprecise and misleading measure of solvency for insurers in run-off. As the evaluation of IBT and CD transactions may often involve insurers in run-off or books of business in run-off, we urge the Working Group to continue its dialogue with other NAIC committees in consideration of this issue and to make some allowance in the Draft for the distortions resulting from the application of RBC when evaluating IBTs and CDs involving insurers or books of business in run-off. Adding a footnote in the Draft to this effect would help sustain interest in this issue.

9. Role of Non-Domiciliary Regulators. (Page 18.) The Draft (Section VIII (3)) requires that all affected US jurisdictions approve or non-object to an IBT or CD. Such a provision is inconsistent with the laws of states which have adopted IBT and CD statutes and pre-judges the deliberations of the Working Group. Furthermore, it would be inappropriate for the regulators of one non-domiciliary state to make their evaluations dependent upon whether another non-domiciliary state would require approval of the transfer. We recommend that this requirement be deleted.

10. Run Off Procedures. (Page 20.) The Draft (Section X) appears to focus attention on run-offs resulting from an IBT or CD, possibly implicating insolvency. The Draft does not appear to discuss the broader issues arising from the business of running off solvent legacy books or the proper financial and regulatory aspects of this market, including the unique management, RBC, accounting and disclosure standards for prudent run-off administration. We believe that the current text can be misleading and confusing and would therefore recommend that this Section be deleted and the subject instead be treated to a separate more fulsome discussion elsewhere.

III. **Miscellaneous Comments.**

The following comments address organizational and other miscellaneous drafting issues.

1. Re-Ordering of Introductory Text. It may be useful to introduce the guidance by starting with a brief introduction/summary narrative of the regulatory approvals and expected timing before detailing the Company Information and Transactional Design in what is currently Sections I and II.

2. Consistency and Lack of Clarity. As indicated in our introductory comments, the Draft is derived from multiple sources that are sometimes inconsistent, duplicative and contradictory and some lack clarity. We recommend that these defects be corrected. For example:
    a. Page 4 et seq., Section II (1) and (2). IBT's and CD's have many common characteristics, but are treated separately and inconsistently. It is preferable to treat them together under the same provisions, followed by a subsection to address those issues which are unique to one or the other.
    b. Page 6, Section II (2)(f). This provision states that: "Nothing in this shall expand or reduce the allocation and assignment of reinsurance as stated in the reinsurance contract". We suggest it be re-worded for clarity.
    c. Page 7 et seq., Section II (3), (4) and (5). These provisions at times indicate that they apply to both IBTs and CDs and at other times do not so indicate. We suggest this text be re-worded for clarity.
    d. Page 8 et seq., Sections III and IV. We believe that these provisions are better read together. We suggest they be combined into one Section.
    e. Pages 9 et seq., Sections IV and V. These provisions derive from multiple sources and at times appear to be unnecessarily burdensome. We suggest that these provisions be reviewed carefully to assure that they are consistent and sufficient for the purpose without imposing excessive burdens. For example, on a number of occasions, As stated in our general comments above, we suggest that the Draft be reformulated to more closely follow existing NAIC and state approval formats, in particular the format used for Form A reviews, with appropriate modifications to accommodate issues arising from IBTs and CDs.
    f. Page 11, Section IV (4)(a). This text is confusing. We suggest it be re-worded for clarity.

3. Protected Cell Insurers. The ProTucket Letter (page 7, item 11) observed that the Working Group had been charged with identifying and addressing the legal issues associated with restructuring insurers using protected cells. Although those issues may have been set aside for future review, we ask that they not be forgotten. We recommend that the Draft, by way of footnote or otherwise, acknowledge that these issues will be considered at some future time when appropriate.

Because of the number and importance of the issues raised in the Draft, we urge the Working Group to remain open to further comments from interested parties.

We appreciate the opportunity to comment upon the Draft and are available to follow-up with further comments and further assistance that the Working Group.

Sincerely,

Robert A. Romano

RAR

cc: Albert Miller, Esq., ProTucket Insurance Company
Jonathan Bank, Esq., Norton Rose Fulbright
Al Bottalico, Norton Rose Fulbright

R&Q Insurance Holdings Ltd

VIA EMAIL

April 26, 2023

Superintendent Elizabeth Kelleher Dwyer
Commissioner Glen Mulready
Co-Chairs, NAIC Restructuring Mechanisms (E) Working Group

Attention: Robin Marcotte rmarcotte@naic.org
Dan Daveline ddaveline@naic.org

Re: Request for Comments – Best Practices Procedures for IBT/Corporate Divisions

Dear Superintendent Dwyer and Commissioner Mulready:

Thank you for the opportunity to comment on the most recent Best Practices exposure. R&Q Insurance Holdings Ltd. (RQIH) continues to support the mission of the Restructuring Mechanisms (E) Working Group and shares the view that state insurance markets would benefit from greater uniformity and robust regulatory standards for Insurance Business Transfers (IBTs) and similar mechanisms.

Properly structured and regulated IBTs can benefit state insurance markets and consumers by strengthening the management of complex risks while promoting capital and operational efficiencies for transferring insurers, leaving them sounder and enabling them to redeploy resources to meet other marketplace needs. But in our view some additional clarity in portions of the recent Best Practices exposure may be helpful in assuring these positive outcomes should the Working Group's proposal become a common standard amongst the states.

Our comments fall into five main categories: the standard of review; licensure requirements; parental guarantees; reinsurance transfers; and the expected end state of this NAIC process. These comments and some suggested clarifications to the exposure are detailed in the following.

Standard of Review
We support the "no material adverse impact" standard and appreciate that this appears to have become the consensus view of the Working Group and interested parties. We raise it here simply to reaffirm our view on the issue since it has been a topic of some ongoing discussions.

R&Q Insurance Holdings Ltd
Two Logan Square, 100 North 18th Street,
Suite 600, Philadelphia PA 19103, USA
Telephone: +1 (267) 675 3400
Facsimile: +1 (267) 675 3410

Registered in Bermuda No. 47341
Registered Office: Clarendon House, 2 Church Street
Hamilton HM11, Bermuda

As has been well articulated by numerous regulators and interested parties, this is a well-tested and well-understood standard in successful use in the Part VII regime in the UK (which regime forms the basis of existing IBT laws in the US), in Oklahoma where IBTs are successfully occurring, in the US courts, and in contract law.

We believe that the other standards that have been discussed from time to time are less tested and could create unintended consequences, increasing the amount of subjectivity that could be applied in practice. These alternate standards could, for example, result in the denial of a proposed IBT transaction simply because of non-material differences in the RBCs of the transferor and transferee. If such a standard of review were to take hold, proposed transactions may not get to the point of being evaluated for their holistic benefit to consumers and a state's insurance marketplace. Additionally, transactions of essentially identical parameters might be approved in one jurisdiction but not another, decreasing instead of increasing uniformity in the state system of insurance regulation.

We therefore encourage that "no material adverse impact" remain the standard as the Best Practices undergoes further development.

<u>Licensure Requirements</u>
In our understanding, the Working Group has historically discussed the need for licensure of IBT transferees as necessary to assure the continuation of guaranty fund eligibility for insureds who would have been eligible for that coverage prior to the IBT transaction. We wholeheartedly support this, and thus appreciate that the most recent exposure draft contains language from the guaranty associations appearing to make clear that the need for licensure of a P&C IBT transferee in a given state or states is related to the impact such licensure would have on guaranty fund coverage. We raise the issue here just to encourage additional clarity around this intent, perhaps through added language such as the following: *"The licensure of transferees in non-domiciliary states should be required if necessary to preserve eligibility for guaranty fund coverage."* We would suggest this be appended to Section II, 1. n. ii (page 5 of the exposure) and in subsequent references.

<u>Parental Guarantees</u>
A key premise of the Best Practices is that conditions post-transaction should not be materially different from conditions pre-transaction. But the exposure includes parental guarantee language that could be interpreted as creating material differences by placing requirements on a transferred book of business that did not exist prior to the transfer. Especially in cases where no parental guaranty has been in place, we wonder why it would be required after the transfer. Further, some transferees may not be part of a holding company system with a parent positioned to make such a guaranty. Thus, requiring guarantees may prevent IBTs from occurring in the future.

Accordingly, we respectfully suggest that the current references to parental guarantees be amended to specify that consideration may be given to guarantees if they were in place at the transferring insurer at the time of the IBT and the transferee is part of a holding company system in which such a guarantee is feasible. For example, Section II, 4. b. (page 8) might be revised to read: *"Where the transferring insurer provided such commitment and the transferee is part of a holding company system enabling such parental commitments, the plan may provide for a commitment of parental and other legally enforceable plans for financial support to run off operations in the event of:…"*

We note that these proposed guarantees appear to emanate from recommendations in a 1997 NAIC whitepaper, which was an initial look at the issue of restructurings some 26 years ago and which thus predated the successful completion of a large number of such transfers in the UK and elsewhere without such requirements.

Reinsurance Transfers

The Best Practices document and the discussions to date have understandably focused on the potential impact of IBTs on individual consumers. But in practice these transactions sometimes involve only books of reinsurance, where the policyholder is not an individual but another insurance company. We suggest that this be recognized in the NAIC proposal with a statement indicating that a transfer solely involving reinsurance, where the transferred policyholder is another insurer, may be considered by regulators as a positive factor in their evaluation of the potential for any material adverse impact on consumers.

Expected End State of this NAIC Process

We believe that additional clarity may be helpful regarding the NAIC process on these Best Practices going forward. We understand that the current goal is to present a finalized document for approval at the NAIC Fall National Meeting, but are unsure of the thinking beyond that point, for example with respect to measures that would further encourage broad adoption amongst the states. Any guidance on this matter would be appreciated.

Thank you for your attention to our comments and proposed refinements to this important exposure. We are available at your convenience should you have any questions in this regard.

Sincerely,

Peter L. Hartt
US Head of Compliance and Regulatory Affairs
R&Q Insurance Holdings Ltd.

R&Q Insurance Holdings Ltd. ('RQIH'), headquartered and operating in Bermuda with extensive operations in the US and Europe, is a leading provider of finality solutions for run-off portfolios and global program capacity for MGAs and their reinsurers. R&Q has a proven track record over three decades of acquiring discontinued books of non-life business and non-life (re)insurance companies and captives in run-off. We have access to capital and the experience of managing run-off which enables us to free management and investors from the cost and constraints of handling discontinued business. We can do this on both sides of the Atlantic with our licensed platforms in the US, Bermuda and Europe.

Draft: 8/17/23

Risk-Focused Surveillance (E) Working Group
Seattle, Washington
August 14, 2023

The Risk-Focused Surveillance (E) Working Group of the Financial Condition (E) Committee met in Seattle, WA, Aug. 14, 2023. The following Working Group members participated: Amy Malm, Chair (WI); Lindsay Crawford, Vice Chair (NE); Blase Abreo (AL); Laura Clements and Michelle Lo (CA); William Arfanis and Jack Broccoli (CT); Ainsley Hurley and Bradley Trim (FL); Daniel Mathis (IA); Cindy Andersen (IL); Roy Eft (IN); Stewart Guerin (LA); Dmitriy Valekha (MD); Vanessa Sullivan (ME); Steve Mayhew and Judy Weaver (MI); Debbie Doggett, John Rehagen, and Shannon Schmoeger (MO); Angela Hatchell (NC); Pat Gosselin (NH); David Wolf (NJ); Mark McLeod (NY); Dwight Radel (OH); Diane Carter, Andrew Schallhorn, and Eli Snowbarger (OK); Diana Sherman (PA); Ted Hurley and John Tudino (RI); Johanna Nickelson (SD); Amy Garcia (TX); Jake Garn (UT); Greg Chew and David Smith (VA); Dan Petterson (VT); and Steve Drutz and Tarik Subbagh (WA).

1. Discussed Updated Guidance for Reviewing Affiliated Service Agreements

Malm stated that the first agenda item is to discuss an updated draft of proposed edits to NAIC handbooks to provide additional guidance for state insurance regulators in reviewing and monitoring transactions and service agreements between insurers and their affiliates. An updated draft of proposed revisions to both the NAIC's *Financial Analysis Handbook* and the *Financial Condition Examiners Handbook* was included in the meeting materials. The updated draft was revised in response to comments received during a recent exposure period, which ended May 8.

Comments were received from UnitedHealthcare and a joint group of interested parties, which primarily focused on placing guidance in the handbooks related to cost-plus reimbursement contracts. The comments were considered by members of the Affiliated Services Drafting Group in developing the updated draft, which included state insurance regulators from Connecticut, Idaho, Maine, North Carolina, Pennsylvania, Texas, Virginia, and Wisconsin.

Bruce Jenson (NAIC) provided an overview of the updated guidance, which included additional language on cost-plus reimbursement contracts whereby the rate charged under the agreement is based upon the cost to perform the service plus a negotiated fee/profit margin to recognize the risk of providing the service. He stated that the guidance indicates that these types of agreements should only be entered into as a method of last resort and may not be acceptable in all jurisdictions.

Chew stated that state insurance regulators recognize that the "method of last resort" language is not viewed favorably by the industry. He proposed the removal of that language from the draft and replacement with language indicating that the state insurance regulator should determine if the company has provided documentation sufficient to support the cost-plus methodology or if another methodology should be suggested. Malm and Broccoli expressed their support for this proposal.

Tom Finnell (America's Health Insurance Plans—AHIP) stated that interested parties object to the "method of last resort" language, as cost-plus methodology is widely used across the industry and is even required by some international jurisdictions for service agreements that involve international affiliates. He agreed that the change proposed by Chew would adequately address the industry concerns.

Malm stated that the guidance has been exposed multiple times over a period of almost two years and has gone through various iterations in response to the comments received. She stated although the guidance is not perfect, it is an improvement over what currently exists in NAIC handbooks, and it will be important in assisting states to review the increased number and complexity of affiliated service agreements being filed with state insurance departments.

Chew made a motion, seconded by Mathis, to refer the proposed guidance to the Financial Analysis Solvency Tools (E) Working Group and the Financial Condition Examiners Handbook (E) Technical Group for consideration of adoption. The motion passed unanimously.

2. Discussed Next Steps in Addressing the 2022 Macroprudential (E) Working Group Referral

Malm stated that the next agenda item is to discuss the Working Group's next steps in responding to the 2022 referral from the Macroprudential (E) Working Group. This referral relates to issues in affiliated service agreements that are being recognized more frequently in private equity (PE)-owned insurers. While the guidance just discussed does not yet address these issues, state insurance regulators wanted to finalize general affiliated services guidance before moving into the more specific topics raised in the referral.

The referral covers two different topics that the Risk-Focused Surveillance (E) Working Group was asked to consider related to affiliated investment management agreements (IMAs) and capital maintenance plans. Regarding the first topic, the referral recommends that the Working Group consider:

> The material terms of the IMA and whether they are arm's length, address conflicts of interest — including the amount and types of investment management fees paid by the insurer, the termination provisions (how difficult or costly it would be for the insurer to terminate the IMA) and the degree of discretion or control of the investment manager over investment guidelines, allocation, and decisions.

The referral also includes some notes from state insurance regulator discussions on this topic, as well as comments received from Risk & Regulatory Consulting LLC (RRC). Malm asked Ed Toy (RRC) to provide an overview of the topic and issues the Working Group should consider in addressing the referral.

Toy stated that the review of IMAs should focus on several key areas to assess whether the agreements were fair and reasonable to the company and policyholders, including the following:

- Is the investment manager registered under the Investment Advisers Act of 1940 (40 Act), and does it acknowledge the fiduciary standard of care?
- Are investment guidelines included and sufficiently detailed to guide the investment managers' activities and allow the company to assess compliance and performance?
- Are the management fees fair and appropriate, reflecting the type of assets managed, the total assets under management, and the investment strategy in the context of the current market?
- Are there appropriate termination provisions?
- Are the investment managers allowed to engage sub-advisers? Does the company have control over such engagements? Who is responsible for the management fees of the sub-advisers?
- Are there adequate reporting requirements that include sufficient information for the company to monitor the investment manager and meet its reporting and regulatory needs?
- Is there language to address the potential for conflicts of interest?

Arfanis asked whether in Toy's experience most affiliated investment managers being utilized by insurers are registered under the 40 Act. Toy stated that his experience has been that 85–90% of affiliated investment managers are registered under the act. However, he stated that newer or less experienced insurance groups are more likely to utilize affiliated investment managers that are not registered under the act.

Jenson asked whether an IMA with broad investment guidelines could result in control of the insurer being ceded to a related party investment manager, as the investment manager could be placed in a position to make most investment decisions on behalf of the insurer. Toy indicated that it is important to ensure that IMAs provide sufficient guidance on the types of investments acceptable to the insurer to provide effective oversight and avoid granting control of the insurer through the agreement. All IMAs grant some discretionary authority to investment managers, but it is important to ensure that there are appropriate bounds to the discretion granted through the agreement.

Malm thanked Toy for his overview of the topic and recommended that a drafting group be formed to develop guidance to assist state insurance regulators in reviewing affiliated IMAs. She encouraged anyone interested in participating in the drafting group to contact NAIC staff to participate in the project.

Malm stated that the other topic addressed in the referral asks the Working Group to consider the following:

> Owners of insurers, regardless of type and structure, may be focused on short-term results which may not be in alignment with the long-term nature of liabilities in life products. For example, investment management fees, when not fair and reasonable, paid to an affiliate of the owner of an insurer may effectively act as a form of unauthorized dividend in addition to reducing the insurer's overall investment returns. Similarly, owners of insurers may not be willing to transfer capital to a troubled insurer.

The referral encourages the Working Group to consider the development of additional guidance on how to require or strengthen capital maintenance agreements between an insurer and its parent company to address these concerns. Malm asked NAIC staff to develop some additional guidance on this topic for the Working Group to consider in a future meeting.

3. Discussed the Financial Analyst/Examiner Salary Survey

Malm stated that a survey of all the states to collect information on pay rates for common financial analysis and examination positions was closed on June 30. Responses to the survey were received from 40+ states and three different contact examination firms. NAIC staff are working to clean the data, adjust it for localized cost of living rates, and then aggregate it to calculate national and regional averages for the various positions.

After the current pay rates are analyzed and aggregated, NAIC staff plan to pull together external market data for comparison, including industry information and salary rates for federal and state banking regulators. The results will then be compared against the existing pay ranges in NAIC handbooks, which will likely result in proposed adjustments to the ranges. The proposed adjustments will be presented to the Working Group for review and adoption ahead of the Fall National Meeting.

4. Received an Update on 2023 Peer Review Sessions

Crawford stated that the NAIC Peer Review Program provides an opportunity for a group of experienced financial analysts and examiners to participate in reviewing each other's recently completed analysis and examination files.

The peer review discussions provide an opportunity to identify both best practices and opportunities for improvement within individual files and on an aggregate level across the country.

Crawford reported that three different peer review sessions have been held in 2023, all of which received excellent participation and feedback from all participants. A financial analysis session was held in February, with a total of 10 states participating in that session. In May, a financial exam session was held with a contractor-led examination theme. Six different states participated in that session, along with contract firm representatives, with a focus on identifying best practices in effectively utilizing contractors to conduct examinations. This session led to several new sound practices being identified and resulted in a referral being sent to the Financial Analysis Solvency Tools (E) Working Group and the Financial Condition Examiners Handbook (E) Technical Group on coordination between analysts and examiners during the fieldwork stages of an exam.

In July, a special Own Risk and Solvency Assessment (ORSA) financial analysis session was held with six states participating. The focus of this session was to identify sound practices in reviewing ORSA filings and incorporating them into financial analysis. Several new sound practices were identified through this session, which NAIC staff are still working to accumulate and finalize.

Crawford stated that due to other ongoing projects and construction at the NAIC central office, the Risk-Focused Surveillance (E) Working Group has decided not to hold any more peer review sessions in 2023. Instead, the Working Group plans to put together a comprehensive webinar for department chiefs and supervisors on the sound practices identified through NAIC peer review sessions to date. The goal of this webinar will be to encourage department leadership to support staff in their implementation of sound practices identified through peer review.

Crawford stated that plans for 2024 include holding another financial analysis session in the first quarter of the year, as well as scheduling two to three additional peer review sessions to meet demand once the NAIC central office is reconfigured.

Having no further business, the Risk-Focused Surveillance (E) Working Group adjourned.

Https://naiconline.sharepoint.com/sites/NAICSupportStaffHub/Member Meetings/E CMTE/2023-2-Summer/RFSWG/Surveillance WG 8-14-23 Minutes.docx

Clarifications for the MWG Reinsurance Worksheet

Summary Response to Comments Received
Joint FSTF/MWG Call
June 20, 2023

1. **OPTIONAL TOOL**: This worksheet is designed as an **OPTIONAL** tool to assist lead state/domiciliary regulators when reviewing reinsurance transactions to allow them to obtain the information necessary to understand the economic impacts, typically upon initial review of the proposed transaction but also potentially when the lead state/domiciliary regulator is performing a historical review of the transaction for some specific purpose.
2. **NOT AN ONGOING FILING**: This worksheet is **NOT** for use as an ongoing filing with the NAIC and/or the lead/domiciliary state. It is an **EDUCATIONAL** tool for lead state/domiciliary regulators to use on an ad hoc basis as needed.
3. **ONLY USED IF NEEDED**: The worksheet is **NOT** designed to be used with **EVERY** reinsurance transaction. It is designed as a consistent tool for lead state/domiciliary regulators to use when reviewing reinsurance transactions for which they need to determine the economic impacts of said reinsurance transactions. If a reinsurance transaction is easily understood without the use of this worksheet, then a worksheet would not be used by the lead state/domiciliary regulator.
4. **NOT A FIXED TEMPLATE**: The worksheet is **NOT** a fixed template which **MUST** be used to answer the lead state/domiciliary regulators' information needs. If an insurer has materials used in its own assessment of the reinsurance transaction which answer the information needs of the lead state/domiciliary regulator expressed in the worksheet, then those materials may be accepted by the lead state/domiciliary regulator rather than requiring the insurer to use the worksheet format. Every effort should be made to **avoid duplicate requests** for information.
5. **OPEN TO REINSURANCE TYPE**: The worksheet **was designed with life reinsurance transactions** as the initial focus, but there is **no reason to limit this tool to life reinsurance transactions**. If the lead state/domiciliary regulator has a P/C reinsurance transaction for which they are struggling to understand the economic impact (despite any existing notes, interrogatories, and Schedule F disclosures for already approved transactions), the lead state/domiciliary regulator would be able to use the worksheet to request the needed information, with appropriate edits. Again, this worksheet should not be used if the lead state/domiciliary regulator has a clear understanding of the transaction from data already provided.
a. Similarly, the worksheet was designed with affiliated transactions as the initial focus, but a lead state/domiciliary regulator should use the template for unaffiliated transactions if existing information does not provide a clear understanding of the transaction.
6. **NOT REINSURANCE POLICY**: The Macroprudential (E) Working Group is working in coordination with the Reinsurance (E) Task Force. This optional, informational tool is **not intended to impact any of its reinsurance policies or procedures**, such as the qualified/reciprocal jurisdiction evaluation process or the U.S. Covered Agreement.
7. **ONLY REFERENCED IN HANDBOOKS**: The worksheet is **not included in the Financial Analysis Handbook or the Examination Handbook**, although it may be referenced there as an optional tool. The worksheet will be available on StateNet.
8. **CONFIDENTIALITY:** The worksheet would be confidential under a states existing confidentiality laws and regulations in place to assess such transactions.

Cross-border Affiliated Reinsurance Comparison Worksheet - by Treaty						
Date:						
Category	**US Stat. Pre-Transaction**	**Impacts of Transaction (Col's B-D)**	**US Stat. Post-Transaction**		**Other Jurisdiction**	**(Alternate Method) - Other Jurisdiction**
Other Jurisdiction Name						
BALANCE SHEET COMPARISON:						
Asset Grouping 1 (e.g., Cash/Investments)						
Asset Grouping 2 (e.g., Policy Loans)						
Asset Grouping3 (e.g., Separate Accounts)						
Other Assets						
TOTAL ASSETS *						
Liab. Grouping1 (e.g., Gen. Acct. Reserves)						
Liab. Grouping2 (e.g., Gen. Acct. Policy Loan Reserves)						
Liab. Grouping3 (e.g., Separate Accounts)						
Unauthorized Reinsurance Liability						
Other Liabilities (*See NOTES SECTION*)						
TOTAL LIABILITIES						
TOTAL ASSET REQUIREMENT COMPARTISON:						
Reserve Grouping1 (e.g., Separate Account Reserves)						
Reserve Grouping2 (e.g., GA Policy Loan Reserves)						
Reserve Grouping3 (e.g., GA Policy Reserves)						
TOTAL RESERVES						
Capital Grouping1 (e.g., Required Capital)						
Capital Grouping2 (e.g., Add'l Capital for Rating Agency)						
Capital Grouping3 (e.g., in Excess of Rating Agency Cap.)						
TOTAL CAPITAL						
TOTAL ASSET REQUIREMENT						
CHANGE IN CAPITAL AND SURPLUS:						
Capital and Surplus						
Net Income						
Change in Liability for Unauthorized Reinsurance						
Aggregate Write Ins for gains and losses in surplus						
Capital Contribution/(Dividends)						
Other Changes in surplus						
TOTAL LIABILITIES & CAPITAL						
SOLVENCY RATIO						
* Supported by listings of asset categories and amounts to highlight differences in supporting assets after the transaction.						
NOTES SECTION:						
(e.g., explain product line, describe transaction and any unique aspects)						
(If Asset Adequacy Testing is included in "Other Liabilities," additional regulatory guidance may be needed, e.g., on counterparty asset assumptions where access is limited.)						

Transaction Details

Please identify the following transaction details if applicable:	Contract 1 (if needed)	Contract 2 (if needed)	Contract 3 (if needed)	Contract 4 (if needed)
Which party of the contract are you (assuming or (retro)ceding)?				
Description risk category covered (mortality, longevity, Cat Risk, etc.)				
Start date				
End date				
Currency				
Sum Insured / Gross Notional amount / PML				
Capital at risk				
Line of Business (e.g. annuities, term, participating guarantee, etc.)				
Risks covered (e.g. longevity, mortality, etc.)				
Type of reinsurance treaty (XoL, Quota share – proportionate, etc.)				
Collateral value				
Value of guarantee				
Name(s) of the reinsurer(s) (please only include top 3 by premium share if more than one)				
Rating of reinsurer(s)				
Countries of reinsurer(s)				
Assets pledged by reinsurer				
Initial premium				
Initial fees				
Value of reserves				
Ceding commission structure		If yes, please provide a brief description		
Any experience refund or loss carryforward features		If yes, please provide a brief description		
Do you use or plan to use any form of derivatives for reinsurance purposes (e.g. longevity or mortality swaps)?		If yes, provide description of these derivatives		
Was any debt or surplus note issued in connection with the transaction? Ex. Such as in an embedded value securitization		If yes, please provide a brief description		

Please identify and describe if any of the following types of arrangements are associated with this transaction:	Description	
Trust		
Funds Withheld		
Coinsurance		
Modified Coinsurance		
Sidecars		Please describe Exit mechanism if known
Any other Joint Venture or SPV		
Third-party capital		

Ceded and Retroceded Details	**Reinsurer Name**	**Jurisdiction**
If ceding to an offshore affiliate please identify the assuming affiliated reinsurer(s) and their regulatory jurisdiction		
If ceding to an offshore affiliate and that affiliate is going to retrocede to another reinsurer, please identify the ultimate assuming reinsurer(s) and their regulatory jurisdiction		

Key Definitions
PML-Probable Maximum Loss
Capital at risk-required capital or capital charge.
Collateral value-the market value of securities pledged as collateral if a trust is set up in connection with the transaction.
Value of the guarantee – For example, third party guarantees in non-standard types of reinsurance. e.g. an MGA owns affiliated insurers, an unaffiliated reinsurer reinsures with the MGA affiliate with a guarantee from the MGA.

Please list the asset types and amounts backing the ceded business and indicate with a * (or some other symbol) if they do not meet the statutory accounting definition of admitted assets

As of Date:

Asset Listing			
Description	**Book Value**	**Market Value**	**NRSRO Rating**

Interpretation of the
Statutory Accounting Principles (E) Working Group

Net Negative (Disallowed) Interest Maintenance Reserve

INT 23-01 Dates Discussed

April 10, 2023, June 28, 2023, August 13, 2023

INT 23-01 References

Current:
SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Annual Statement Instructions

INT 23-01 Issue

1. The statutory accounting guidance for interest maintenance reserve (IMR) and the asset valuation reserve (AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within SSAP No. 7 is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the annual statement instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance residing within the annual statement instructions.

2. As detailed in SSAP No. 7, paragraph 2, the guidance for IMR and AVR applies to life and accident and health insurance companies and focuses on IMR and AVR liability recognition and distinguishing between IMR and AVR:

> 2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

3. The IMR guidance in the annual statement instructions provides information on the net balance. A positive IMR represents net interest rate realized gains and is reported as a liability on a dedicated reporting line. A negative disallowed IMR represents net interest rate realized losses and is reported as a miscellaneous other-than-invested write-in asset in the general account and nonadmitted.

4. IMR balances between the general account and separate accounts are separate and distinct. Meaning, a net negative IMR in the general account only represents activity that occurred in the general account that was allocated to IMR. However, the net positive or negative balance of the general account influences how the net positive or negative balances are reported in separate account statements (and vice versa). (A net negative IMR balance in the general account may not be disallowed if there is a covering net positive IMR in the separate account. Negative IMR that is not disallowed is reported as a contra-liability.) The instructions for reporting the net negative and positive balances are detailed in the annual statement instructions:

> Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned "Interest Maintenance Reserve" on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the "Change in Disallowed Interest Maintenance Reserve" in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement. The following information is presented to assist in determining the proper accounting:

General Account IMR Balance	Separate Account IMR Balance	Net IMR Balance
Positive	Positive	Positive (See rule a)
Negative	Negative	Negative (See rule b)
Positive	Negative	Positive (See rule c)
Positive	Negative	Negative (See rule d)
Negative	Positive	Positive (See rule e)
Negative	Positive	Negative (See rule f)

Rules:

a. If both balances are positive, then report each as a liability in its respective statement.

b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.

c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.

d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.

e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.

f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

5. In October 2022, the ACLI requested the Statutory Accounting Principles (E) Working Group to reassess the guidance for net negative (disallowed) IMR, with a request to consider admittance of those amounts. The ACLI noted that the nonadmittance of disallowed negative IMR can have adverse negative ramifications for insurers with two key themes:

a. In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.

b. Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity's financial health or its policyholders.

6. In considering the request, the Working Group concluded that, for year-end 2022, there would be no change to statutory accounting guidance and deviations from statutory accounting principles would need to be approved via a permitted or prescribed practice. The Working Group then held company-specific educational sessions in January 2023 to receive detailed information regarding negative IMR and received a subsequent comment letter from the ACLI.

7. During the 2023 Spring National Meeting, the Working Group further discussed the topic of negative IMR and directed NAIC staff to proceed with drafting guidance for a 2023 solution and to begin work towards a long-term solution.

INT 23-01 Discussion

8. This interpretation prescribes limited-time, optional, statutory accounting guidance, as an exception to the existing guidance detailed in SSAP No. 7 and the annual statement instructions that requires nonadmittance of net negative (disallowed) IMR as a short-term solution. Specifically, this interpretation impacts the annual statement instruction rules regarding disallowed negative IMR detailed in rules 'b,' 'd' and 'f' shown in paragraph 4. As this interpretation overrides existing guidance, it will require a 2/3rd vote.

9. Reporting entities are permitted to admit net negative (disallowed) IMR with the following restrictions:

a. Reporting entities that qualify pursuant to paragraph 9b, are permitted to admit net negative (disallowed) IMR up to 10% of the reporting entity's adjusted general account[1] capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner. The capital and surplus shall be adjusted to exclude any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted[2] net negative (disallowed) IMR.

b. Reporting entities applying this interpretation are required to have a risk-based capital (RBC) greater than 300% after an adjustment to total adjusted capital (TAC) that reflects a reduction to remove any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted net negative (disallowed) IMR. Compliance with this adjusted RBC calculation shall be affirmed for all quarterly and annual financial statements for which net negative (disallowed) IMR is reported as an admitted asset in the

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[1] The general account capital and surplus includes surplus reflected in the separate account; therefore, an aggregation of general account and separate account surplus is not necessary.

[2] As the separate account does not have "admitted" assets, broad reference to "admitted net negative (disallowed) IMR" throughout this interpretation includes what is admitted in the general account and what is recognized as an asset in the separate accounts.

general account or recognized as an asset in the separate accounts. Reporting entities shall provide documentation to illustrate compliance with this requirement upon state regulator request. Reporting entities with an adjusted RBC calculation of 300% or lower are not permitted to admit net negative (disallowed) IMR in the general account or recognize IMR assets in the separate accounts.

c. The net negative (disallowed) IMR permitted for admittance shall not include losses from derivatives that were reported at fair value prior to derivative termination[3] unless the reporting entity has historically followed the same process for interest-rate hedging derivatives that were terminated in a gain position. In other words, there is a requirement for documented, historical evidence illustrating that unrealized gains from derivatives reported at fair value were reversed to IMR (as a liability) and amortized as part of IMR. Reporting entities that do not have evidence of this past application are required to remove realized losses from derivatives held at fair value from the net negative (disallowed) IMR balance to determine the amount permitted to be admitted. Reporting entities that begin a new process for the use of hedging derivatives, perhaps with a theoretical process to treat derivative losses and derivative gains similarly, but do not have evidence illustrating the historical treatment of derivative gains through IMR are not permitted to include derivative losses in the net negative (disallowed) IMR permitted to be admitted. This evidence is required separately for the general account, insulated separate account and non-insulated separate account if losses from derivatives previously reported at fair value are currently being allocated to IMR in those accounts.

10. Reporting entities that admit net negative (disallowed) IMR shall follow the following process:

a. All net negative (disallowed) IMR in the general account shall first be admitted until the capital and surplus percentage limit, as detailed in paragraph 9.a, is reached.

b. If all general account net negative (disallowed) IMR has been fully admitted, and the reporting entity is still below the paragraph 9.a capital and surplus limit, then the reporting entity can report net negative (disallowed) IMR as an asset in the separate accounts. Reporting entities that have both insulated and non-insulated separate accounts shall recognize IMR assets proportionately between the insulated and non-insulated statements until the aggregated amount recognized as an admitted asset in the general account and as an asset in the insulated and non-insulated statements reaches the percentage limit of capital and surplus detailed in paragraph 9a.

11. Reporting entities that admit net negative (disallowed) IMR in the general account shall report the admittance in the balance sheet as follows:

a. Reporting entities shall report the net negative (disallowed) IMR as an aggregate write-in to miscellaneous other-than-invested assets (line 25) (named as “Admitted Disallowed IMR”) on the asset page. The net negative (disallowed) IMR shall be admitted to the extent permitted per paragraph 9a, with the remaining net negative (disallowed) IMR balance nonadmitted.

b. Reporting entities shall allocate an amount equal to the general account admitted net negative (disallowed) IMR from unassigned funds to an aggregate write-in for special surplus funds (line 34) (named as “Admitted Disallowed IMR”). Although dividends are

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[3] Reference to derivative termination throughout this interpretation includes all actions that close out a derivative, including, but not limited to, termination, expiration, settlement, or sale.

contingent on state specific statutes and laws, the intent of this reporting is to provide transparency and preclude the ability for admitted negative IMR to be reported as funds available to dividend.

12. Reporting entities that record net negative (disallowed) IMR as an asset in the separate account shall report the recognition in the balance sheet as follows:

a. Reporting entities shall report the permitted net negative (disallowed) IMR as an aggregate write-in to miscellaneous other-than-invested assets (line 15) (named as "Recognized Disallowed IMR") on the asset page.

b. Reporting entities shall allocate an amount from surplus equal to the asset recognized as disallowed IMR as an aggregate write-in for special surplus funds (line 19) (named as "Recognized Disallowed IMR) on the liabilities and surplus page.

13. Reporting entities admitting net negative (disallowed) IMR are required to complete the following disclosures in the annual and quarterly financial statements for IMR:

a. Reporting entities that have allocated gains/losses to IMR from derivatives that were reported at fair value prior to the termination of the derivative shall disclose the unamortized balances in IMR from these allocations separately between gains and losses.

b. Reporting entities shall complete a note disclosure that details the following:

i. Net negative (disallowed) IMR in aggregate and allocated between the general account, insulated separate account and non-insulated account,

ii. Amounts of negative IMR admitted in the general account and reported as an asset in the separate account insulated and non-insulated blank,

iii. The calculated adjusted capital and surplus per paragraph 9a, and

iv. Percentage of adjusted capital and surplus for which the admitted net negative (disallowed) IMR represents (including what is admitted in the general account and what is recognized as an asset in the separate account).

c. Reporting entities shall include a note disclosure that attests to the following statements:

i. Fixed income investments generating IMR losses comply with the reporting entity's documented investment or liability management policies,

ii. IMR losses for fixed income related derivatives are all in accordance with prudent and documented risk management procedures, in accordance with a reporting entity's derivative use plans and reflect symmetry with historical treatment in which unrealized derivative gains were reversed to IMR and amortized in lieu of being recognized as realized gains upon derivative termination.

iii. Any deviation to 13.c.i was either because of a temporary and transitory timing issue or related to a specific event, such as a reinsurance transaction, that mechanically made the cause of IMR losses not reflective of reinvestment activities.

iv. Asset sales were not compelled by liquidity pressures (e.g., to fund significant cash outflows including, but not limited to excess withdrawals and collateral calls).

INT 23-01 Status

14. The consensuses in this interpretation were adopted on August 13, 2023, to provide limited-time exception guidance to SSAP No. 7 and the annual statement instruction for the reporting of net negative (disallowed) IMR. The provisions within this interpretation are permitted as a short-term solution until December 31, 2025, and will be automatically nullified on January 1, 2026.

15. The effective date of this interpretation may be adjusted (nullified earlier or with an extended effective date timeframe) in response to Statutory Accounting Principles (E) Working Group actions to establish statutory accounting guidance specific to net negative (disallowed) IMR.

16. Further discussion is planned.

Application Guidance for Admitting / Recognizing Net Negative (Disallowed) IMR

General Account:

1. Net negative IMR in the general account that exceeds net positive IMR in the separate accounts is considered "disallowed" general account IMR. (Determination of the disallowed IMR in the general account shall be compared against the aggregate IMR balance in all separate accounts.)

2. Net negative disallowed IMR in the general account shall be reported as an aggregate write-in for other-than-invested assets as "Admitted Disallowed IMR" on line 25 of the asset page and nonadmitted. The change in nonadmittance shall be reported on line 41 in the summary of operations.

3. To the extent the reporting entity is permitted to admit net negative disallowed IMR pursuant to the provisions in this interpretation, the reporting entity shall admit the disallowed IMR reported on line 25 of the asset page to the extent permitted, with the change in nonadmittance reflected on line 41 in the summary of operations.

4. Reporting entities shall report an amount equal to the general account admitted net negative (disallowed) IMR as an aggregate write-in for special surplus funds (line 34 of the Liabilities, Surplus an Other Funds page) named as "Admitted Disallowed IMR."

5. Reporting entities shall include note disclosures in the quarterly and annual financial statements as required in paragraph 13 of the interpretation.

Separate Account:

6. Net negative IMR in the separate account (aggregated IMR in both insulated and non-insulated separate accounts) that exceeds net positive IMR in the general account is considered "disallowed" separate account IMR. If the aggregate separate IMR is positive, with a negative IMR in the insulated separate account and positive IMR in non-insulated separate account (or vice versa), then the negative IMR in the insulated separate account is not permitted to be reported as an asset. In those situations, the separate account has an aggregate positive IMR balance.

7. Net negative (disallowed) IMR in the separate account permitted to be recognized as an asset, as the admittance in the general account did not utilize the full percentage of adjusted capital and surplus permitted within this interpretation, shall be proportionately divided between insulated and non-insulated separate accounts if both separate accounts are in a negative position. If the separate account IMR is an aggregate net negative, but only one separate account blank is in a negative position, then only the separate account blank with a net negative position can recognize disallowed IMR as an asset.

8. If negative IMR in the separate account has previously been recognized as a direct charge to surplus, the reporting entity shall recognize an asset as an aggregate write-in for other-than-invested assets as "Recognized Disallowed IMR" on line 15 of the separate account asset page, with an offsetting credit to surplus. This credit to surplus shall reverse the charge previously recognized. This process shall continue in subsequent quarters if additional separate account IMR is permitted as an asset to the extent IMR was previously taken as a direct charge to surplus. Once prior surplus impacts have been fully eliminated, then the entity shall follow the guidance for new net negative (disallowed) IMR as detailed in the following paragraph. If subsequent quarters result with a decline in the permitted IMR asset in the separate account, then the asset shall be credited with an offsetting charge to surplus.

9. If the reporting entity enters a net negative (disallowed) IMR position (meaning, there has not been a prior charge to surplus for net negative (disallowed) IMR), then the entity shall recognize the asset as

an aggregate write-in for other-than-invested assets as "Disallowed IMR" on line 15 of the separate account balance sheet, with an offsetting credit to IMR (line 3 of the liability page) until the IMR liability equals zero. This process shall continue in subsequent quarters if additional net negative IMR is generated from operations and is permitted as an asset under the provisions of this interpretation. If subsequent quarters result with a decline in the permitted IMR asset in the separate account, then the asset shall be credited with an offsetting charge to surplus.

10. Reporting entities shall report an amount equal to the asset recognized reflecting net negative (disallowed) IMR as an aggregate write-in for special surplus funds (line 19) (named as "Recognized Disallowed IMR." This shall be included in each separate account statement (insulated and non-insulated) if net negative disallowed IMR is recognized as an asset in that statement.

11. Reporting entities shall include note disclosures in the quarterly and annual financial statements as required in paragraph 13 of the interpretation.

NAIC Summer National Meeting

OSFI's Recent Journey with Insurance Data and Analytics
August 15, 2023

Jacqueline Friedland, FCIA, FCAS, FSA
Executive Director
Risk Assessment and Intervention Hub

Canada

Outline

- Personal background
- It started with the FCT
- Another winter holiday, another analytics project (RADAR)
- Meltwater media monitoring tool
- More AI in use – reinsurance NLP pilot
- OSFI Blueprint and transformation
- OSFI data and analytics and next steps

Personal background – provides context for the story

- Actuary by training
- More than 35 years in industry (consulting and insurers)
- Author of CAS and SOA textbooks used for actuarial examinations
- Advisory committee member of University of Waterloo and University of Toronto actuarial programs
- Transformation expertise
- Mantra: enhance efficiency and effectiveness (neither at the expense of the other)
- Joined OSFI fall 2020 in P&C insurance
- Was not (am not) your typical supervisor

It started with FCT

- Obligation of AA to conduct FCT annually
- Single most important report from the perspective of prudential regulation – too important to only be understood by actuarial specialists
- Rigorous actuarial standards of practice and very strong relationship of CIA and OSFI have led to high quality of FCT reports
- FCT includes solvency and going concern scenarios
- Challenge I faced:
  - How do I teach supervisors (not actuarial specialists) how to use and what to look for in the FCT
  - How do I make the process for review of FCT reports most efficient and effective
- Benefits I had:
  - Teaching experience
  - President of the CIA

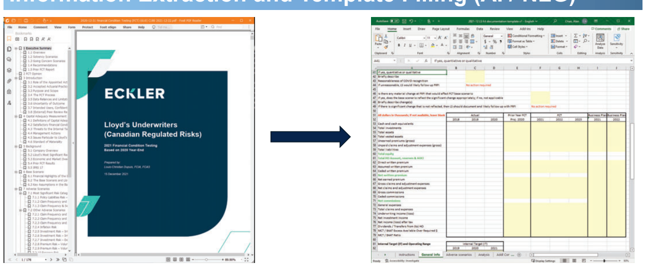
Looking for efficiency and effectiveness

- Estimates of time to analyze FCT report:
  - 2 days max per insurer
  - ½ day read text with focus on executive summary and charts / tables
  - 1 day use FCT tool to help develop conclusions with respect to risk assessment
  - ½ day document findings and ratings
- Use tool to answer questions such as:
  - Were the current selected scenarios, assumptions, and ripple effects, consistent with prior year for the same insurer and were they consistent with peers?
  - Was the affect of a particular adverse scenario on key financial metrics consistent with prior year for the same scenario for the insurer and consistent with peers for the same scenario?
  - Were the differences in actual results and expected results (which could be calculated given data entry from the prior year FCT) within a reasonable range, and specifically were they greater than the standard of materiality selected by the AA?
  - Were key financial ratios that could be derived from the base scenario (which is required by actuarial standards to be based on the insurer's plan) consistent with historical experience?
  - Were changes in the insurer's strategy appropriately reflected in the base and adverse scenarios?

FCT version 1 – P&C and mortgage insurers only

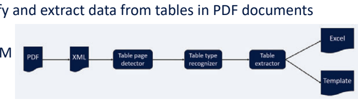
- Started during Christmas break (2022), with six colleagues willing to be testers (tremendous benefits of early adopters)
- Excel-based tool with five tabs: instructions, general information, adverse scenarios, analysis, VU (OSFI's supervisory system of record)
- Clearly marked cells for data entry vs. calculations, conditional formatting drew user's attention in analysis tab, conditional tests made it clear where action was needed
- Create Users Guide at same time that tool was developed (translation to French)
- Special coding for each row and column to enable aggregation for peer group and trend analyses by our analytics teams
- Roll out in January, require use immediately (training and drop-in sessions)
- Data input in version 1 by lead supervisors (LSs)
- First year of use, LS needed to enter prior and current year information

FCT version 1.5 – Intelligent Automation Information Extraction and Template Filling (AI / NLG)



FCT version 1.5 Conclusions – 1 of 2

- Automated NLP tool was used to extract data from FCT report to validate quality of the FCT template submissions across 147 P&C insurers
- The tool was developed in Python to identify and extract data from tables in PDF documents using several applications, including:
  - Coding via Jupyter Notebook in TES DSVM
  - Ghostscript – pdf interpreter
  - Pooler – pdf to xml converter
  - Python – delegator, Pandas, openpyxt



- Each FCT report contained ~100 to 300+ pages and 100+ tables with limited standardized format
- Results were promising as it was found that 85% of data were correctly extracted and filled, 11% were missing, and 4% were incorrectly captured
- Causes of incorrect data capture primarily related to differing formats and non-standardized data (e.g., reporting in $000 or $M)

FCT version 1.5 Conclusions – 2 of 2

- Data extracted from FCT (PDF) Report were compared against data submitted through FCT template to identify potential reporting errors across 95 P&C insurers' base scenarios, about 10k data points
- We discovered that 5.5% of data points in the base scenario were inconsistent
  - Some data divergence (3.7%) was due to unit difference, rounding, and negative sign
  - 1.3% of data points had potential reporting errors
  - 0.5% were due to data extraction errors

OSFI BSIF 9

FCT version 2

- Discussed work with FCT at OSFI's P&C Actuarial Advisory Committee and with relevant CIA committees
- P&C AAs agreed to complete the FCT template for FCTs prepared in 2022 (big saving for LSs)
- FCT template (in Excel) became a regulatory return
- Expanded to life AAs in 2023
- No push back from AAs
- Significant retooling required in 2023 due to IFRS 17
- Test and learn – lots of learning as move to Power BI and then back to Excel
- Still a work in progress!

OSFI BSIF 10

Another winter holiday, another analytics project

- Serve in new role with new industries, new data, and new metrics
- See tons of Power BI dashboards but missing the "so what"
- Ask for an Excel dump with ten years of quarterly data for each industry (P&C insurance, life insurance, and banks) and begin to play
- Pull out my university statistics textbook (with a 1981 copyright date)
- Begin to create Users Guide as I create the tool
- Build with colleagues who will be the early adopters
- Collaborate widely across teams – expect this will be big (and it was!)
- Align metrics to OSFI's new Supervisory Framework with emphasis on business risk and financial resilience
- Strive to deliver v1 working in environment where the following are prioritized:
  - Efficiency over perfection
  - Innovation over status quo
  - Transparency over harmony

OSFI BSIF 11

Risk Assessment Data Analytics Report (RADAR)

- Interactive dashboard of common financial risk indicators across insurance and banking
- Integrated with the new Supervisory Framework focusing on financial resilience
- Includes business risk components and supervisory ratings
- Initial step in the risk assessment and monitoring process for all institutions
  - For smaller, less complex institutions, use of RADAR may be all an LS needs
  - For larger institutions, use of RADAR helps focus and prioritize an LS's work
- Colour coding indication for areas of potential concern or follow up (calibrated across peers and historical trends)
- Supported by comprehensive user guides and interactive training

OSFI BSIF 12

Risk Assessment Data Analytics Report (RADAR)

OSFI BSIF

Risk Assessment Data Analytics Report (RADAR)

How to Use RADAR

RADAR generates key financial metrics based on financial information obtained from FRFIs' quarterly regulatory returns. For each quarter, monitoring would begin with a review of the FRFI's financial metrics. The LS would note any metrics outside of the usual ranges and the amounts by which such values deviate from the set ranges, if applicable.

A FRFI's financial metrics are used to determine the level of supervisory attention required. A metric that falls outside of the usual range is not necessarily considered adverse. In some quarters, it may not be unusual for financially stable FRFIs to have more than one metric with results outside of the usual range. For example, a rise or decline in the equity markets may result in a significant change in shareholder equity for a company (or net available assets if a branch). Because shareholder equity (or net available assets) is used as the divisor in some of the metric calculations, these metrics may fall outside of their usual range. The metrics and trends are valuable in identifying FRFIs likely to experience financial difficulties. The metrics are not, in themselves, indicative of an adverse financial condition.

RADAR will be modified over time to reflect continuous improvement initiatives. Ongoing feedback to the SD&AI team from LSs is strongly encouraged.[2]

[1] For a complete list of insurers and banks currently assigned to the RMOG, see Peer Group and Data Source file.
[2] Contact RAHDistribution-InsuranceDataandAnalytics@osfi-bsif.gc.ca with any questions or suggestions.

1. Earnings

1.1 Expense Ratio Test A (Peer Group)
1.2 Expense Ratio Test B (Historical Experience)

Purpose[4]

An insurer's expense ratio is a measure of profitability calculated by dividing the expenses associated with acquiring, underwriting, and servicing policies by the insurance revenue of the insurer. An insurer's expenses include (but are not limited to) advertising and marketing, employees' wages, commissions for the sales force, technology expenses, rental costs, and office equipment. The expense ratio is a measure of an insurer's efficiency before factoring in claims on the policies underwritten or investment gains or losses. The expense ratio is combined with the net loss ratio to determine an insurer's net combined ratio.

Calculation

Under IFRS 4, the calculation of the expense ratio was:

Expense ratio = (gross commissions – ceded commissions + taxes + other acquisition expenses + general expenses) / net earned premium.

Under IFRS 17, the calculation of the expense ratio is:

Expense ratio = [(amortization of insurance acquisition cash flows – amortization of reinsurance acquisition cash flows + general and operating expenses – interest on debt - other interest expense - other finance costs)] / (insurance revenue + allocation for reinsurance premiums).

Test A (Peer Group)

This test compares the current quarter expense ratio to values that were selected based on a detailed review of the historical experience by different product types[5] for federally regulated P&C insurers.

OSFI BSIF

Meltwater Media Monitoring Tool (real AI) – 1 of 5

- From the viewpoint of the leader who was never a supervisor … what do I need to do to a successful LS?
    - Read, understand, assess the material sent by the insurer to me at quarter-end and year-end
    - Read, understand, assess the major actuarial reports including the valuation of insurance contract liabilities and the FCT reports
    - Conduct reviews (on-site, off-site, desk, thematic, etc.) on specific topics of interest and / or concern
    - Stay aware of what is happening with the insurer
- Are there tools that can help me do any of the above more efficiently and effectively?
- Meltwater is tremendous for staying aware
- In our RMOG team, there are LSs with portfolios of 12-15 insurers, use of Meltwater is critical to their success in being informed in a timely manner – equally critical for our largest IAIGs

OSFI BSIF

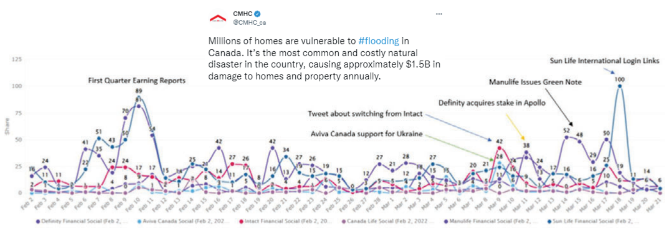
Meltwater Media Monitoring Tool – 2 of 5

- Allows for monitoring of media and social media across companies, industries, and topics
- Used for institution and parent company monitoring
- Ability to identify media spikes, trends, risks, and sentiment

OSFI BSIF

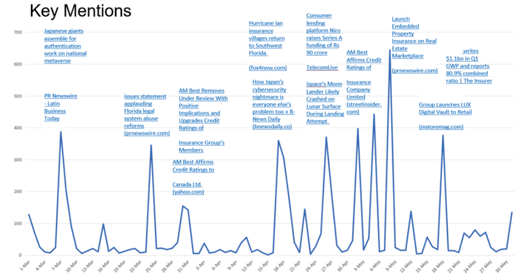
Meltwater Media Monitoring Tool – 3 of 5

Tracking customers comments about insurance and perceived climate risk issues.



Meltwater Media Monitoring Tool – 4 of 5

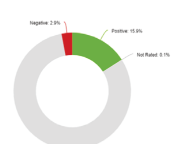
Key Mentions

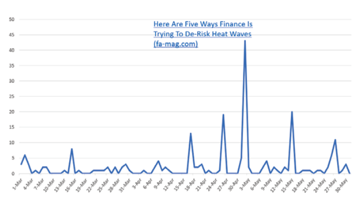


The mention trend widget provides insight into the trend over time of the combined volume of social and editorial content over the last quarter.

Meltwater Media Monitoring Tool – 5 of 5

Negative Sentiment





The sentiment widget provides insight into how social and editorial content may be categorized as having positive, negative and neutral sentiment over the last quarter. The line graph illustrates the trend of mentions containing negative sentiment over the last quarter.

More AI in use … Reinsurance NLP Pilot

- Rough reinsurance renewal season year-end 2022
- Seeking details about reinsurance use (attachment points, percentage participation, limits, etc.)
- Information exists in AA reports on liabilities and FCT but in varied, unstructured formats that lack consistency across insurers and time
- Experimenting with natural language processing to extract details from actuarial reports
- Quality of extraction is dependent on defined parameters and ability to train extraction model
- Test and learn

Treaty Name	Treaty Effective Period	Type	Canadian Entities Covered	Specific to Canadian Operations	Layer	$Million Limit1/QS % Cession
Appendix G on AAR	Appendix G on AAR	Appendix G on AAR	Appendix G on AAR	Appendix G on AAR	Appendix G on AAR	Appendix G on AAR
Marine XOL	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Marine XOL	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Trade Credit QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				
Trade Credit QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				
Trade Credit XOL	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Trade Credit XOL	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Personal Accident - Main XOL Treaty	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Personal Accident - Main XOL Treaty	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Personal Accident - Main XOL Treaty	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Personal Accident - Main XOL Treaty	Jan 1, 2022 to Dec 31, 2022	Excess of Loss				
Automobile QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				
Automobile QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				
Automobile QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				
Cyber QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				
Cyber QS	Jan 1, 2022 to Dec 31, 2022	Quota Share				

OSFI Blueprint and Transformation

Become a leading data and analytics driven regulator that makes well-informed decisions and is able to supervise and regulate pro-actively to changes in the risk environment

Continuously improve our data technology infrastructure to support leading-edge data and analytical capabilities

Make investments to build, support, and promote the development of leaders and staff in becoming agile, proficient, and forward-looking in data trends and analytics

OSFI Data and Analytics

Communities

- Risk and Data Analytics (RDA)
- Supervision Data and Analytical Insights (SD&AI)
- Insurance Financial Risk (IFR) and other specialist groups

Initiatives

- Data Collection Modernization Initiative (DCM)
- SupTech Network
- Advanced Analytics Working Group
- Technology Exploration Space (TES) and Advanced Data Analytics Platform and Technologies (ADAPT)
- Data Analytics Community of Practice (DACoP)
- Data Literacy Strategy

Next Steps for SD&AI

What we aim to achieve

Vision

SD&AI aims to become the Centre of Excellence for supervision risk analytics
Enable data-driven, risk-based, supervisory decision-making and financial risk assessment by providing timely, forward-looking, insightful analytic solutions

How we will achieve it

Strategy

Focus our mandate on:

- Providing analytic solutions to support supervisory risk identification and financial risk assessment
- Elevating OSFI's analytical capabilities by leveraging AI / ML
- Conducting financial analytics, reporting, and research on special supervisory topics
- Supporting "Vision 2030" with a focus on financial resiliency
- Promoting data literacy and the effective use of supervisory information

What we will prioritize near term

Key Initiatives

Prioritize initiatives that:

- Automate intelligence extraction and enable access to supervisory information
- Enable continuous and real-time monitoring of risk exposure
- Forecast financial metrics and business plan
- Identify high-risk and vulnerable institutions

Questions?