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STATE OF WASHINGTON

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Investment Modernization Interested Parties:

Thank you for participating in our dialogue on June 28. Your individual comment letters and feedback during dialogues have helped us understand your positions and how they relate to our position.

The model act was developed to be used as an integral whole. Accepting some sections and discarding others, without a major re-working of the remaining parts, presents the possibility for significant unintended consequences. Our goal in drafting was to start with the model suggested by interested parties and modify the model only to address significant, recurring issues that we have dealt with in the past. Many of the "changes" in our draft are merely form and format changes necessary to conform to Washington drafting standards.

During our June 28 dialogue, several participants expressed concern about my June 24 interpretation that investments in FNMA, FHLMC, and FHLB securities did not qualify as government obligations for the purposes of Sec. 8(2) of our draft bill. That position was based on a change to the SVO manual that seemed to indicate those investments are not government obligations. Your comments caused our re-examination of the SVO manual. Based on that re-examination, I believe the better position is that investments in FNMA, FHLMC, and FHLB securities do qualify as government obligations under Sec. 7(2) of the draft proposal, and, therefore, are not subject to the 3% and 5% limitations of Sec. 8(2).

Also during our discussion on June 28, a question was raised about investments in insurance subsidiaries. Those investments are currently governed and limited by RCW 48.13.210 which is not specifically carried over, but is repealed in the draft modernization bill. It appears to me that investments in insurance subsidiaries are authorized by Sec. 7(4) and limited by Sec. 8(1)(c) of the draft bill, and that the limitations on those investments are the same as current statutory language.

I do not understand the expressed concern that the draft modernization proposal mixes solvency issues with investment issues. In my view, those issues are interrelated and must be addressed together for effective regulation.

A comment was received to the effect that cash flow planning is not appropriate for an investment policy. I believe that it is absolutely essential that cash flows be considered as investment policies are developed.

In response to concerns about including procedures in an investment policy, please consider this language from the draft modernization proposal:

> Sec. 6. . . .The content and format of an insurer's investment policy are at the insurer's discretion, but shall include written guidelines appropriate to the insurer's business. . . .

The subsequent language in Sec. 6 does not require the inclusion of procedures within the investment policy.

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I am not sure I fully understand the concern expressed about Sec. 8(5). I do not anticipate that the OIC will "look through" every mutual fund investment. I think this provision is "stand-by" authority to be used when an insurer evidences signs of deteriorating financial condition. It is in everyone's best interest for OIC to be able to address an insurer's financial distress. It is not possible to develop a law or rule that would specify action in every possible scenario. Sec. 8(5) attempts to provide a general authority in an area that has been a cause for distress in the past. I will gladly consider specific suggestions for modifying this section to better meet the needs of both interested parties and the OIC.

Sec. 12 seems to me to be a restatement of authority currently existing in other areas of the Insurance Code. Pulling the authority together in one place should facilitate review and compliance. OIC is fully aware of the complexity and cost of reporting and for that reason has been very judicious in its requests for special reports, generally only in special circumstances.

Language substantially similar to Sec. 13 is contained in Chapters 48.03, 48.31B, and 48.31C RCW, and perhaps in other areas of the Code. In the fourteen years that I have been a deputy commissioner, this office has used that authority probably fewer than five times, always with advance notice to and agreement by the insurer. In more than one instance the authority was exercised at the request of the insurer.

I am not adverse to defining leverage or other terms the interested parties believe would facilitate implementation. Please send me your suggested definitions.

Comments regarding Sec. 7's restrictions on Canadian investments, restrictions on foreign country investments, and requiring investments only in first mortgages were addressed in my prior responses to interested parties. I have seen no new information suggesting that there is a basis to change my prior position.

Only one more dialogue is currently scheduled to work on our investment modernization proposal. That discussion is scheduled here in Tumwater at 1:30 pm on Friday, July 9. If you have additional comments and suggestions regarding our proposal, please get them to me as soon as you can. I will attempt to post those comments for all interested parties to access prior to July 9.

OIC's goal in this process is to develop a consensus bill to be proposed to the Legislature in January 2011. I will be happy to schedule additional opportunities for us to discuss our investment modernization proposal, if the interested parties believe those opportunities would be helpful in achieving consensus. Please let me know if you want additional meetings.

OIC's internal schedule is to present a consensus bill to Commissioner Kreidler on August 10. At that time I plan to ask his approval to add the investment modernization proposal to his legislative agenda.

Sincerely,

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Company Supervision