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July 8, 2010

James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division
5000 Capitol Blvd.
Tumwater, WA 98501

Re: Chapter 48.13 RCW – possible amendment

Dear Mr. Odiorne:

Thank you for the continuing opportunity to provide feedback on the OIC draft of the Investment of Insurers Model Act, Defined Standards Version. We appreciate the OIC's focus on protecting those persons/entities who would be hurt in case of insurer insolvency. Our comments strive to bring balance, clarity and fairness to the Act.

1. Section 2, Definitions

Requested Change: Add definitions for the following terms:

“Leverage” means the ability to control a large amount of assets by borrowing funds.

“Mutual fund” means a mutual fund or exchange traded fund registered with the Securities and Exchange Commission of the United States under the Investment Company Act of 1940

“Rated by the SVO” means any security that is directly rated by the Securities Valuation Office or that is given an equivalent Filing Exempt rating as prescribed in the “Purposes and Procedures Manual” of the NAIC Securities Valuation Office

“U.S. Government securities” means any security issued directly by the United States Government including its agencies and government sponsored enterprises as prescribed in the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

Reason for Requested Change: Each of the above definitions adds clarity to the intent of the act.

Leverage: The term “Leverage” found in Section 5 is ambiguous and far too encompassing. In our view it requires removal or definition. Leverage covers, in part, financial leverage, operating leverage, margin

buying, and derivatives. If the term leverage is to be retained, then it should be defined to provide clarity for the evaluation criteria. The sample language is a basic definition.

Mutual funds: Making “mutual funds” a defined term in Section 2 and adding exchange traded funds (ETF) to the definition adds clarity and aligns the term with the SVO’s Purpose and Procedure Manual (Part 6). An ETF is very similar to a mutual fund and should be clearly identified as an authorized investment.

Rated by the SVO: The language in Sections 2 and 8 does not reflect the current practice at the SVO for Filing Exempt (FE) securities. We suggest incorporating language that reflects the practices described in the NAIC SVO's Purposes and Procedures Manual.

U.S. Government Securities: It is clear that there are different interpretations of U.S. Government Securities by various interested parties in this proposed Act. It is our suggestion to incorporate the definition of U.S. Government securities as defined in the SVO's Purposes and Procedures Manual. The SVO states in Part 2, Section 4(c)(i) – (iv) that U.S. Government securities are exempt from filing and in conjunction with Part 3, Section 5, the SVO has stated that securities meeting the provision of Part 2, Section 4(c)(i) – (iv) have an enforceable claim to the direct, full faith and credit or other support of the U.S. Treasury.

2. Section 6(1), Insurer Investment Policy

Requested Change: Modify the wording to indicate that the board-approved investment policy includes guidelines as to:

- (1) The general investment policy of the insurer and specific policies, procedures and controls covering all aspects of the investing function;

Reason for Requested Change: We believe this modification helps to clarify that the investment policy itself need not (and we think should not have to) contain the supporting procedures developed by management. The intent here is to require only that the board-approved investment policy will include guidelines as to general investment policy and the specific policies, procedures and controls; but not all of the detailed policies, procedures and controls themselves.

3. Section 7(4), Authorization of Subsidiaries and Section 8(1)(c)(ii)

OIC Current Draft:

Section 7(4): Common stock or equity-like preferred stock or equity interests in any United States (~~or Canadian~~) business entity, or shares of mutual funds registered with the Securities and Exchange Commission of the United States under the Investment Company Act of 1940, other than SVO listed mutual funds, and subsidiaries (as defined in RCW 48.31B.005 or 48.31C.010) engaged exclusively in the following businesses:.....

(k) Owning one or more subsidiary

- (i) insurers, health care service contractors, or health maintenance organizations to the extent permitted by this chapter, or
- (ii) businesses specified in paragraphs (a) through (k) of this subsection inclusive, or
- (iii) any combination of such insurers and businesses.

Section 8(1)(c): Investments authorized by Section 7(4), (~~other than subsidiaries of the types authorized under [cite applicable provisions of holding company law]~~) twenty percent (20%) of admitted assets in the case of life insurers and twenty-five percent (25%) of admitted assets in the case of non-life insurers;

(i) Individual investments authorized by Section 7(4) of this Act, except for subsidiaries, shall not exceed 10% of the voting interest in any one entity.

(ii) Investments authorized in Section 7(4) of this Act in one or more subsidiaries shall not exceed the lesser of 10% of admitted assets or 50% of policyholder surplus:

Requested Change: We believe these provisions could produce unintended disparate impacts on insurance groups depending on whether they have a parent-insurer or parent non-insurer corporate structure. We have not developed a specific alternative to this wording, but ask that the OIC consider the use of subsidiary limits for purposes of satisfying MAR that reflect the model act, in a way that does not favor one corporate structure over another

Reason for Requested Change: The defined standards version of the model act allows for equity interest of 20% (life) or 25% (non-life) of admitted assets and 100% of subsidiaries to qualify for the “minimum asset requirement” (MAR). The model language is indifferent to whether a corporate structure is defined as a holding company (all insurance companies are held in a peer relationship by a non-insurance holding company) or as a parent-insurer/subsidiary-insurer relationship.

By adding the subsidiary language in Section 7(4), a parent-insurer/subsidiary-insurer corporate structure is held to a tighter restriction of qualifying assets for the MAR than that of a non-insurer holding company corporate structure.

It is also not clear to us if a non-life company holding common stock, mutual funds and subsidiaries in excess of 25% should apply the code for MAR purposes first to the 25% limit for the investments, then to the 10% limit for subsidiaries. The introductory language in Section 8(1)(c) makes it difficult to determine the amount of qualifying assets for MAR.

4. Section 7(6), Real Property

OIC Current Draft:

(6) Real property, together with the fixtures, furniture, furnishings and equipment pertaining thereto in the United States (~~or Canada~~), which produces or after suitable improvement can reasonably be expected to produce substantial income;

Requested Change: Remove the word “substantial.”

Reason for Requested Change: What the word “substantial” means and how is it quantified is unclear. The language “expected to produce income” should be reasonable and sufficient in determining if an asset qualifies to meet MAR.

5. Section 8(2), Individual Limitations

OIC Current Draft:

(2) Individual limitations. For purposes of determining compliance with Section 11, securities of a single issuer and its affiliates, other than the government of the United States and subsidiaries authorized (~~under [cite applicable provisions~~

~~of holding company law]~~) by Section 7(4) of this Act, shall not exceed three percent (3%) of admitted assets in the case of life insurers, and five percent (5%) in the case of non-life insurers. Investments in the voting securities of a depository institution, or any company that controls a depository institution, shall not exceed five percent (5%) of the insurer's admitted assets

Requested Change: Change "government of the United States" to "U.S. Government securities."

Reason for Requested Change: If the definition for U.S. Government securities is added to Section 2, then the language should change to reflect the defined term.

Additional Requested Clarification: There has been debate whether or not a mutual fund or mutual fund family is considered an issuer. We interpret this provision to focus on the securities through which ownership interests in the issuer are held, and not on securities of others that this entity may pool and make available with management services for investors to invest in. An "issuer" in this case may issue securities such as common/preferred stock, bonds, and commercial paper. As we interpret this provision, a mutual fund family is not an issuer, nor is a mutual fund.

We would appreciate confirmation of this interpretation.

6. Section 8(5), Special Rules for Mutual Funds

OIC Current Draft:

(5) Special rule for mutual funds, pooled investment vehicles and other investment companies. If the commissioner considers it desirable in order to get a proper evaluation of the investment portfolio of an insurer, the commissioner may require that investments in mutual funds, pooled investment vehicles or other investment companies be treated for purposes of this Act as if the investor owned directly its proportional share of the assets owned by the mutual fund, pooled investment vehicle or investment company.

Requested Clarification: We assume this paragraph is for the Insurance Commissioner's use in monitoring the solidity of insurers. We interpret the "NAIC SVO I debt rated" language in Section 7(7) as not intended to introduce potential compliance violations if a look-through were done and a mutual fund were found to hold a NAIC SVO I debt rated security. As we have noted before, the review of mutual funds can be particularly troublesome in regards to the timeliness and completeness of data on their fund. Determining the extent of any holdings within a mutual fund that would not individually qualify towards MAR could be difficult at purchase and subsequent review periods.

We would appreciate confirmation of these interpretations.

7. RCW 48.13.340, Authorization of Investments

RCW Current Code:

No investment, loan, sale or exchange thereof shall, except as to the policy loans of a life insurer, be made by any domestic insurer unless authorized or approved by its board of directors or by a committee charged by the board of

directors or the bylaws with the duty of making such investment, loan, sale or exchange. The minutes of any such committee shall be recorded and reports thereof shall be submitted to the board of directors for approval or disapproval.

Requested Change: RCW 48.13.340 is no longer needed and should be repealed.

Reason for Requested Change: Section 4 “Authorized Investments” and Section 6 “Insurer Investment Policy” both speak to internal controls. We believe the investment policy is the appropriate place for governance, statement of controls and delegation of authority, and therefore Section 48.13.240 would not be carried forward into the new Act.

8. RCW 48.13.350, Record of Investments

RCW Current Code:

(1) As to each investment or loan of the funds of a domestic insurer a written record in permanent form showing the authorization thereof shall be made and signed by an officer of the insurer or by the chair of such committee authorizing the investment or loan.

(2) As to each such investment or loan the insurer's records shall contain:

(a) In the case of loans: The name of the borrower; the location and legal description of the property; a physical description, and the appraised value of the security; the amount of the loan, rate of interest and terms of repayment.

(b) In the case of securities: The name of the obligor; a description of the security and the record of earnings; the amount invested, the rate of interest or dividend, the maturity and yield based upon the purchase price.

(c) In the case of real estate: The location and legal description of the property; a physical description and the appraised value; the purchase price and terms.

(d) In the case of all investments:

(i) The amount of expenses and commissions if any incurred on account of any investment or loan and by whom and to whom payable if not covered by contracts with mortgage loan representatives or correspondents which are part of the insurer's records.

(ii) The name of any officer or director of the insurer having any direct, indirect, or contingent interest in the securities or loan representing the investment, or in the assets of the person in whose behalf the investment or loan is made, and the nature of such interest.

Requested Change: Remove paragraph 1 and revise paragraph (2) to read “(1) A written record of each investment or loan of the funds of a domestic insurer shall contain:”

Reason for Requested Change: It is our interpretation that Section 6(1) covers this aspect of the existing code through the statement “controls covering all aspects of the investing function”. We believe RCW 48.13.350(1) is no longer needed as it is a statement of control.

9. Section 11(1), Minimum Required Assets

OIC Current Draft:

(1) Invested assets may be counted toward satisfaction of the minimum asset requirement only so far as they are invested in compliance with this Act and applicable ((regulations)) rules promulgated and orders issued by the commissioner pursuant to this Act. Assets other than invested assets may be counted toward satisfaction of the minimum asset requirement at admitted annual statement value.

Requested Clarification: The Act states that assets other than invested assets may be counted towards MAR. It is our interpretation that Deferred Tax Asset and Deferred Compensation Assets qualify towards MAR as other than invested assets. Further, our interpretation is that Deferred Tax Liabilities are used to determine the MAR.

We would appreciate confirmation of these interpretations.

We see benefit to our policyholders and the objectives in regulating insurance by modernizing the Washington Insurance Code's investment provisions. We appreciate the OIC's collaborative start in taking on the task. Thank you, again, for allowing insurer CFOs the opportunity for early comments. It is a constructive process, and one we expect can produce additional, beneficial feedback as other interested parties join the discussion.

Sincerely,

PEMCO Mutual Insurance Company
PEMCO Insurance Company
PEMCO Life Insurance Company



Steven A. Ricco
Vice President, Treasurer
And Chief Financial Officer