

Thank you for your response to our proposed draft of an investment modernization bill. We are considering your thoughtful comments within OIC, and hope in the very near future to provide a working draft to you and an expanded group of interested persons. With the working draft we will send a schedule of meetings at which we can have face-to-face meetings to discuss the draft bill.

In our meeting in September 2009, I heard what appeared to be a consensus that our efforts at modernization should be built around the NAIC defined standards model (#383) for insurer investment. Model 383 represents a negotiated middle ground between the control regulators had grown accustomed to and the freedom insurers desired; a huge change for both insurers and OIC in how investments are managed and regulated. The concepts underlying this paradigm shift demand a wholistic view of the entire model, with an understanding that an attempt to isolate sections or subsections may not produce meaningful results.

The following comments are not intended to respond to specific insurers' specific comments, but are presented as combined responses to specific comments.

Sec. 3(1)(b) and (c) authorize the Commissioner to adjust minimum financial security benchmarks for individual companies by order and for classes of insurers by rule. All Washington Administrative Procedures Act (APA) and due process protections currently enjoyed by insurers will remain in place and apply to the adjustment of benchmarks.

Sec. 3(2)(a)(vi) anticipates that OIC and insurers will monitor reinsurers' and counterparties' financial statements, rating agency reports, regulatory encounters, and other available information in an effort to analyze an insurer's risk for reinsurers and counterparties.

Sec. 4, Sec. 5, and Sec. 6 provide broad direction and discretion to boards of directors for establishing, documenting, and monitoring their company's investment practices. That broad authority granted to boards of directors is constrained by prudence standards generally applicable to those managing business entities and by very specific criteria constraining the Commissioner's review of an insurer's investment practices. These sections do not require the Commissioner's prior approval, but focus instead on a board of directors' active involvement in developing, documenting, and monitoring the implementation and effectiveness of investment practices and policies.

Sec. 7 and Sec. 8, as expected, generated a significant number of comments. One commenter provided a matrix which compared the NAIC model to our proposed draft bill. We are attaching our version of that matrix which also includes comparison with provisions of Chapter 48.13 RCW as it currently exists. We hope this matrix will help explain our positions.

Several commenters questioned our proposed limits on foreign investments, our proposal to restrict foreign investments to those in SVO 1 rated countries, and our inclusion of Canada as a foreign country instead of being included on the same basis as U.S. investments. OIC works daily with insurers to maintain appropriate insurer financial position and liquidity levels. In those unfortunate situations in which insurer financial position and liquidity cannot be maintained through a collaborative process, OIC is required to seek receivership and resolve the insurer and its issues. It is our understanding that sovereign jurisdiction and treaty issues present the potential for significant challenges to liquidating or marshalling foreign investments. Those challenges have and can in the future stymie efforts to maintain financial position and liquidity, and for that reason we believe limits greater than contained in the model on foreign investments are appropriate.

Our proposed inclusion of Canada as a foreign country and our proposal to limit foreign investment to those originating in SVO 1 rated countries have a common origin. Until 2003, foreign investments were limited to 5% for Canadian investments and those required by a foreign country to support reserves for policies issued in that particular country. In 2003, domestic insurers petitioned for a relaxation of the foreign investment restrictions, and we negotiated the current restrictions on foreign investment which we carried over into our modernization bill draft. We do not see changes, since 2003, that suggest that the current negotiated foreign investment restrictions are no longer appropriate or in need of change.

Our proposal struck language in the introductory paragraph of Sec. 7, not to indicate a total prohibition against investments in partnerships, joint ventures, and limited liability companies, but as an indication that those investments would not be counted toward the minimum asset requirement identified in Sec. 11. Interests in partnerships, joint ventures, and limited liability companies are usually not readily marketable, and, therefore, provide limited liquidity. Having those types of assets and their limited liquidity as part of the minimum assets requirement presents the possibility that a financially stressed insurer could not efficiently access necessary liquidity in order to survive.

In Sec. 7(4) we prepared our draft bill presuming that exchange traded funds are included in the common understanding of mutual funds. We also prepared our draft with the intention that any expressed limitations on investments in mutual fund shares apply to all funds within a family of funds. We feel strongly about that position because of recent experiences demonstrating financial distress because an insurer's diversification consisted of investments in individual funds within a family. Because of common management of the family, all funds declined together and resulted in the demise of the insurer.

In Sec. 7(4)(a)-(k) we included investments in subsidiaries because those investments tend to be less liquid and often prevent the agility insurers need to meet changing circumstances. The limitations we proposed reflect general industry averages for the particular type of investment. We are concerned that some Washington domestics do significantly exceed industry averages in this area.

We drafted the limitations in Sec. 8(1)(c) with an understanding of general industry averages, which is presumably the standard that would be applied to investments when a reasonableness standard is applied.

Sec. 8(5) is unmodified model law language. It is our understanding that the allocation authority is intended for laser applications only in specific special situations and is not intended for broad beam application.

Sec. 11(1) is model law language modified to recognize Washington usage regarding the terms "regulation" and "rule." OIC's understanding is that this section only defines a minimum level of invested assets that must be maintained by an insurer.

Sec. 14(1) and (2) contain authorities currently held and exercised by the Commissioner.

Sec. 14(3) and (4) represent new discretionary authority to allow insurers expanded investment authority upon a showing by the insurer that insureds, creditors, and the general public are sufficiently protected.

Sec. 18 is model law language that was modified only to identify the fact that any rule-making must be done under the constraints of the (APA). The APA is a grant of authority from the Legislature to local and state government agencies to adopt rules. APA process requirements provide ample time for insurers to be involved in rule adoption and for reasonable structured implementation.

Your comments are helping us further evaluate our proposed draft bill. We hope these comments help you understand our position. At this point, my plan is to present the draft you reviewed to a larger group of interested parties. Your comments will be used as discussion starters for a series of face-to-face meetings designed to move us toward a consensus bill for introduction in 2011.

We will be contacting you within about a week with information about our face-to-face meetings. If you have other comments, please send them to us a week before the first meeting so we can share them with other interested parties.

Overview

Broad Investment Statute Comparison

Class Sec. 7.	Sub-Class	Model	Draft	48.13 RCW	Comments
Cash (1)		No Limit	No Limit	FDIC Limit	
Bonds (2)	Bonds	No Limit	No Limit	No Limit	
	Preferred stock debt like	No Limit	No Limit	life 15%/non 10%	
	Junk & Medium Bonds	20%	20%	20%	
	SVO 1 listed mutual funds	No Limit	No Limit	Not allowed	
	CMOs	No Limit	No Limit		
Loans (3)	Mortgages	life 45%/non 25%	life 45%/non 25%	Overall 65%/home office 10%	
Real property (5)	Home office	10%	10%		
	Real property investments	life 20%/non 10%	life 20%/non 10%		
Equities (4)	Subsidiaries insurers	No Limit	life 20%/non 25% (10% voting interest ¹)	20%/ (10% voting interest ¹)	Global Financial Meltdown & 2009 insurer failure. Too much equities
	Subsidiaries-insurance operations	No Limit			
	Common Stock	life 20%/non 25%		See bonds above	
	Preferred Stock equity like			Not allowed	
	Equity interests			Not allowed	
	Mutual funds			Not allowed	
Foreign (7)	Cash	20%	10% SVO 1 rated countries	Not allowed	Countries can collapse, added legal processes, et cetera
	Loans			Not allowed	
	Real property			Not allowed	
	Bonds			10% SVO 1 rated countries ²	
	Equities				
	Canadian	No Limit			
Other (8-12)	International Development ORG (8)	2%	2%	Not allowed	
	Policy loans (9)	No Limit	No Limit	No Limit	
	Tangible personal property (10)	2%	2%	Not allowed	
	Other investment by rule/OIC (11)	No Limit	No Limit	No Limit	
	Basket investment (12)	5%/10%	5%/10%	10%	
Individual Limits		life 3%/non 5%	life 3%/non 5%	4%	Madoff, Federal Old Line, & a 2009 insurer failures. Too much with a single entity
Board of Director Approval		Policy & Procedures	Policy & Procedures	Each transaction	
¹ Non-majority voting interest (10% to 50%) in non-publicly traded equities are often illiquid (not available for claim payments) and difficult to sell for fair value.					
² 2003 Insurers' compromise from 5% Canadian and foreign reserve amounts.					