



OFFICE OF
INSURANCE COMMISSIONER

December 9, 2010

Bret Myers, Assistant Treasurer
Group Health Cooperative
320 Westlake Avenue North, Suite 100
Seattle, Washington 98109-5233

Re: Chapter 48.13 RCW – Insurer Investment Modernization

Dear Mr. Myers:

Thank you for your recent written comments on our proposal to modernize Chapter 48.13 RCW. We especially appreciate your specific drafting suggestions. These comments provide our view of the issues you raised, and are presented in the same order in which you raised them.

Section 3.1(b) – Minimum Financial Security Benchmark

The goal of NAIC model law 283, and OIC's proposed revision of chapter 48.13 RCW, is to provide insurers with more flexibility and autonomy in their investments, while maintaining adequate solvency levels to protect consumers. It has been our experience that financially distressed insurers, particularly smaller insurers, tend to gravitate to riskier, higher yield investments in times of stress. Often that course of action provides no real relief for the underlying causes of financial distress and in the long run impedes recovery.

We see no conflict between our proposal and the RBC statutes found in RCW 48.05.430-485 and RCW 48.43.300-370. We believe that an insurer's implementation of an order under Section 3(1)(b), and the benefit generated from that implementation, will be relatively long term. To wait until an insurer reaches the company action level RBC to enter a Section 3(1)(b) order adjusting a specific insurer's minimum financial security benchmark denies the insurer and OIC the ability to implement an effective corrective action in a meaningful timeframe.

It is worth noting that at December 31, 2009, only three insurers could have been subject to a Section 3(1)(b) order. Two of those insurers were MEWAs whose investment practices could have benefited from an order. The third insurer was only slightly below the 3.5 trigger point and is the subsidiary of a well-capitalized, stable regulated parent.

Section 8.1(c)(ii) – Limit on Subsidiary Investments

An insurer's liquidity risk was our focus as we crafted Section 8(1)(c)(ii). In our opinion, "bricks and mortar" are not liquid assets; they cannot be readily liquidated to assist in a financial crisis. It is our further opinion that investments in subsidiaries, and especially regulated subsidiaries, are probably no more liquid than "bricks and mortar" assets; there is not likely to be an active market, and, even if there is, the regulatory process may prevent timely production of liquidity.

In an industry, such as this, where liquidity is important and, at times, critical, we believe it is not prudent to allow unlimited investment in subsidiaries.



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Limitation of Investment Exposure to Only Insurers Domiciled in the U.S., Canada, and Other NAIC SVO1 Rated Countries

The primary reason for any regulation of insurer investments is assurance that insurer assets will be appropriately available to fulfill insurer obligations to policyholders. Regulation of insurer investments is largely by prohibition or by limitation of both quality and quantity. Proxies are used to set certain quality limitations; one such proxy is the SVO rating for the country from which the investment is issued.

As we have recently witnessed, even developed SVO1 countries with sophisticated market regulatory schemes are subject to financial crises in which investment quality is an issue. To allow investments in countries with a rating lower than SVO1 where a probability exists that market regulatory schemes may not be well developed and effective, increases investment risk and undermines the primary purpose of regulating insurer investments.

We continue to believe that better policyholder protection is provided by maintaining the SVO1 rating for Section 7(7) investments. Insurers will still be able to invest in lower rated countries, to the extent permitted by Section 7(12).

Investments in Mutual Funds and ETFs

Our perspective of regulating insurer investments for policyholder protection applies equally to mutual funds and ETFs investing in countries with a rating lower than SVO1.

You urge us to amend our legislative proposal to specifically provide that the individual limitations contained in Section 8(2) apply to individual mutual funds and ETFs rather than to families or groups of related mutual funds and ETFs. Your argument is that the design and regulation of mutual funds "avoids the possibility of an entire family of funds' performance and/or solvency deteriorating because of the mismanagement of one fund within the family."

From our perspective, it seems that many funds within a family of funds effectively have the same management. Basically the funds differ primarily in the assets they hold. On that basis we believe that "mismanagement of one fund within the family" would most likely be replicated in other funds within the family.

Applying the individual limitations of Section 8(2) to individual funds rather than to the family, would, in our estimation, only multiply both qualitative and quantitative risks.

Proposed New Paragraph to Section 11 – Effect of Investment Restriction

My recollection of our early discussions with interested parties is that there was a desire to follow an NAIC model as much as possible, relying on the NAIC Accounting Practices and Procedures Manual (APPM) to address any issues not specifically addressed in the law. Since Section 11 of our proposal is model law modified only to consider Washington specific drafting requirements, and since RCW 48.05.073 and RCW 48.43.097 require compliance with the APPM on issues not specifically addressed in Washington law, we believe the suggested additional paragraph 5 for Section 11 is neither necessary nor appropriate. By not including suggested paragraph 5, and, therefore, deferring to the APPM, this proposed bill also achieves greater national uniformity, which is an expressed desire of the interested parties.

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Please do not take these comments as an indication that discussion/negotiation on our proposed bill has ended. These comments are intended only to convey our position and thought process in preparing the current draft. We are definitely interested in continuing a dialogue by which we can improve our understanding of each others' positions. That understanding may allow us to agree to further modification of the draft bill.

Sincerely,



JAMES T. ODIORNE, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division

cc: Interested Parties