

NAIC HIGHLIGHTS — SPRING 2009 NATIONAL MEETING**The NAIC**

The National Association of Insurance Commissioners (the “NAIC”) works to coordinate the efforts of the insurance commissioners of the U.S. states and territories and the District of Columbia (including by promulgating model laws and regulations and encouraging adoption thereof by legislators and regulators). The NAIC held its Spring 2009 National Meeting from March 14, 2009 through March 18, 2009 in San Diego, California. At this meeting, many important issues were discussed by the various NAIC committees, task forces and working groups. Set forth below are certain highlights of the meeting.

Reinsurance Regulatory Modernization Framework Implementation

As discussed in previous NAIC Highlights, the NAIC has adopted a Reinsurance Regulatory Modernization Framework Proposal (the “Framework”) to reform reinsurance regulation for both domestic and foreign reinsurers electing to participate.¹ The Framework sets forth, at a conceptual level, a single-state system of licensure for U.S. reinsurers, called “National Reinsurers” (each licensed by a U.S. jurisdiction qualified as a “Home State”), and a single-state system of certification for non-U.S. reinsurers, called “Port of Entry Reinsurers” (each certified by a U.S. jurisdiction qualified as a port of entry state (a “POE State”). The Framework contemplates the creation of a department within the NAIC that would establish standards to be satisfied by a jurisdiction in order for it to qualify for Home State or POE State authority.

The Reinsurance Task Force met on March 15, 2009 and discussed, among other things, two significant steps to be taken to implement the Framework. First, the Reinsurance Task Force explained that it was preparing draft federal enabling legislation to be exposed for comments and then submitted to Congress for consideration in the current session. Shortly after the Spring 2009 National Meeting, the Reinsurance Task Force exposed a draft bill, titled the “Reinsurance

¹ NAIC Highlights — Winter 2008 National Meeting (Dec. 19, 2008) 1-2, *available at* http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2826/NAIC_Highlights_Winter_2008_National_Meeting.pdf; *see also* NAIC Highlights — Fall 2008 National Meeting (Oct. 3, 2008) 3-7 (describing the Framework in further detail), *available at* http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2718/NAIC_Highlights_Fall_2008_National_Meeting.pdf. For further background regarding the Framework, *see* NAIC Highlights — Summer 2008 National Meeting (June 12, 2008) 1-3, *available at* http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2616/NAIC_Summer_2008.pdf; NAIC Highlights — Spring 2008 National Meeting (April 8, 2008) 1-2, *available at* http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2582/NAIC_Spring_2008.pdf.

Regulatory Modernization Act” (the “RRMA”), for comments until April 23, 2009.² The RRMA would create a Reinsurance Supervisory Review Board (the “RSR Board”), a nonprofit corporation to be “administered by the NAIC as a transparent, publicly accountable entity composed of State insurance regulators.” The RRMA would delegate authority to the RSR Board (based on standards recommended by the NAIC and adopted by the RSR Board) (a) to determine which U.S. jurisdictions qualify as Home State or POE State supervisors; (b) to evaluate non-U.S. supervisory regimes and determine if they are eligible to enter into regulatory cooperation and information agreements with POE State supervisors (and thus be designated as “Qualified Non-U.S. Jurisdictions”);³ and (c) to develop uniform supervisory recognition, information-sharing and regulatory cooperation agreements to be entered into between POE State supervisors and such Qualified Non-U.S. Jurisdictions.⁴ As contemplated by the Framework, the RRMA also provides that the Home State or POE State supervisor would assign a rating to the applicable National Reinsurer or Port of Entry Reinsurer, respectively, with such rating translating into certain minimum reinsurance collateral requirements applicable to such reinsurer for reinsurance assumed from U.S. cedents.⁵

² The draft RRMA is available at http://www.naic.org/documents/committees_e_reinsurance_fed_legislation_draft.pdf.

³ In further detail, Section 6(c) of the RRMA provides that “[t]he [RSR Board] shall evaluate the reinsurance supervisory systems of non-U.S. jurisdictions, both initially and on an ongoing basis, consider the rights, benefits and the extent of reciprocal recognition afforded by non-U.S. jurisdictions to reinsurers licensed and domiciled in the U.S., determine the appropriate supervisory recognition approach for such jurisdictions, and create and publish a list of jurisdictions eligible to be recognized as Qualified Non-U.S. Jurisdictions.”

⁴ Under Section 2(d) of the RRMA, the RSR Board also would be required to “preserve the confidentiality of supervisory information within the Board’s control, and enter into agreements with State, federal, and non-U.S. financial supervisory and law enforcement officials and agencies for sharing supervisory information on a confidential basis.”

⁵ For a detailed description of the reinsurance collateral provisions in the Framework, see NAIC Highlights — Fall 2008 National Meeting, *supra* note 1 at 5-6. Additionally, to update to our description of concurrent independent state initiatives regarding reinsurance collateral requirements (*See* NAIC Highlights — Winter 2008 National Meeting, *supra* note 1 at 1-2 & n.5.), on December 24, 2008, New York State published a notice of proposed rule-making in the New York State Register with a revised proposed Tenth Amendment to New York Insurance Regulation 20 (the “Reg. 20 Proposal”). The Reg. 20 Proposal is available at http://www.ins.state.ny.us/r_prop/pdf/rp20a10t.pdf, and certain related documents (including the Notice of Proposed Rule Making and a regulatory impact statement) are available on the Proposed Regulations webpage of the New York State Insurance Department (the “NYSID”) at <http://www.ins.state.ny.us/rproindx.htm>. The Reg. 20 Proposal (a) provides that credit may be taken by an authorized ceding insurer for a cession to an unauthorized reinsurer if certain financial and solvency requirements are met; (b) sets forth a sliding scale of the maximum credit that may be taken as a result of ceding to an unauthorized reinsurer due primarily to its ratings by certain recognized rating agencies; (c) requires an authorized ceding insurer to ensure that certain financial and solvency requirements are met; (d) sets forth additional required provisions for reinsurance agreements with unauthorized reinsurers; (e) allows cessions to an unauthorized non-U.S. reinsurer if the Superintendent of the New York State Insurance Department executes a memorandum of understanding with the reinsurer’s domiciliary jurisdiction and such jurisdiction provides reciprocity to U.S. reinsurers; and (f) sets forth additional principles-based credit risk management standards for authorized ceding insurers. The Reg. 20 Proposal reflects revisions from the NYSID’s October 2007 working draft (*See* NAIC Highlights — Winter 2008 National Meeting 2 n.5.); however, the NYSID has not yet adopted the Reg. 20 Proposal.

Second, the Reinsurance Task Force explained that standards need to be developed concurrently for use by the RSR Board in determining whether jurisdictions qualify as Home State or POE State supervisors. The Reinsurance Task Force requested that interested regulators and interested parties submit their proposals for such standards, which will be used by the NAIC (a) to develop standards to be recommended to the RSR Board and (b) to develop model legislation for jurisdictions intending to act in such supervisory roles. The Reinsurance Task Force plans to hold an interim meeting in early May to discuss comments on the draft RRMA and other issues relating to implementation of the Framework.

Rating Agency Initiatives

The Rating Agency Working Group met on March 16, 2009. It is charged with gathering information regarding and assessing (a) the reliance on ratings of Nationally Recognized Statistical Rating Organizations (“NRSROs”) by the NAIC, the insurance industry and the market, including the problems inherent in such reliance, (b) “[t]he problems inherent in reliance on ratings, including the filing exempt process⁶ and [risk based capital],” (c) “[t]he reasons for recent rating shortcomings, including but not limited to structured security and municipal ratings,” (d) “[t]he current and potential future impact of ratings on state insurance financial solvency regulation,” and (e) “[t]he effect of the use of NRSRO ratings on public confidence and public perception of regulatory oversight quality of insurance.”⁷

At its meeting, the Rating Agency Working Group discussed NAIC staff reports (a) summarizing the ways that NRSRO opinions affect the NAIC and state regulatory process and identifying ways that the NAIC might lessen such reliance,⁸ and (b) analyzing insurance industry experience resulting from credit rating transitions (the relative speed with which a rating moves from one rating category to another) of the securities they own (including NRSRO-rated securities that went through the filing exempt process mentioned in note 6, *supra*) and the effects of rating downgrades (particularly on structured securities that may be less liquid than corporate securities). The Rating Agency Working Group also discussed public reports by the following groups analyzing the reasons for the shortcomings in ratings (including the potential conflicts of interest arising from the “issuer pays” compensation model) and providing certain recommendations (*e.g.*, revising rating agency policies regarding documentation, transparency, review of models and conflicts of interest, or the potential need for external oversight if rating agency actions are not sufficient to ensure the integrity and transparency of ratings): (a) the Financial Stability Forum on Enhancing Market and

⁶ The “filing exempt process” referenced is set forth in the Purposes and Procedures Manual of the NAIC Securities Valuation Office (“SVO”).

⁷ 2009 Charges, Rating Agency (E) Working Group, http://www.naic.org/committees_e_rating_agency.htm.

⁸ This report is available at http://www.naic.org/documents/committees_e_rating_agency_comdoc_naic_staff_report_use_of_ratings.doc.

Institutional Resilience, (b) the President’s Working Group on Financial Markets, (c) the Securities and Exchange Commission and (d) the International Organization of Securities Commissions.⁹ The Rating Agency Working Group directed NAIC staff to assist with developing a questionnaire, which is expected to be finalized in the next few weeks and then distributed to NRSROs to help gather additional information. The Rating Agency Working Group will evaluate the NRSRO replies and determine whether, and how to proceed with their negotiations. Ultimately, “[t]he [Rating Agency] Working Group will write and present a final report documenting the findings and any recommendations for corrective action available to the NAIC, its members, and possible regulatory recommendations to the federal government.”¹⁰

On March 16, 2009, the Executive Committee met and received a report from the SVO Initiatives Working Group (the “SVOIWG”), which is charged with reviewing the potential expansion of the SVO credit assessment role, including the potential formation of a new NAIC-affiliated NRSRO.¹¹ The SVOIWG reported that a draft business plan and a related financial plan have been completed and described the actions required to form such an entity and register it as an NRSRO with the SEC.¹² The SVOIWG expects to make its recommendations regarding next steps to the Internal Administration (EX1) Subcommittee before the Summer National Meeting.¹³ Before moving forward with the concept, however, the SVOIWG noted that there would need to be “[a] consensus of the members that the establishment of a NRSRO compliments [sic] the Mission of the NAIC” and “[t]he issue has been subject to debate among members of the [SVOIWG] but consensus has not yet been reached.”¹⁴ Additionally, a public hearing would need be held to solicit public comments regarding the establishment of such an NRSRO before proceeding.¹⁵

Federal Initiatives

Although the U.S. federal government typically does not regulate the business of insurance, in certain circumstances the federal government has stepped in to address issues of national concern (e.g., the Terrorism Risk Insurance Act and the National Flood Insurance Program). Certain broad-reaching federal initiatives also could have a significant impact on the insurance industry.

⁹ Links to reports of these groups are available on the Rating Agency Working Group’s website at http://www.naic.org/committees_e_rating_agency.htm, and an NAIC staff summary of the reports is available at http://www.naic.org/documents/committees_e_rating_agency_comdoc_naic_staff_summary_of_reports.doc.

¹⁰ 2009 Charges, Rating Agency (E) Working Group, *supra* note 7.

¹¹ SVO Initiatives (EX) Working Group, http://www.naic.org/committees_ex_svo_initiatives.htm.

¹² For a list of current NRSROs and links to related documents, see <http://www.sec.gov/answers/nrsro.htm> and <http://www.sec.gov/divisions/marketreg/ratingagency.htm>, respectively.

¹³ Executive (EX) Committee Working Group Reports (March 16, 2009) 1-2 (Handout One distributed at Executive Committee Meeting).

¹⁴ *Id.* at 1.

¹⁵ *Id.*

Federal Regulation of Insurance

The Government Relations Leadership Council Task Force (the “GRLC Task Force”) met on March 17, 2009. Its charges include that it shall “[m]onitor and analyze federal and state legislative/regulatory actions regarding financial services and other issues of importance to the NAIC membership.”¹⁶ Among other issues, the GRLC Task Force received updates on recent proposals relating to the potential federal regulation of insurance to various degrees. These include the potential creation of (a) a federal regulator of systemic risks¹⁷ to help fill current regulatory gaps (perhaps to regulate holding companies with insurance company subsidiaries); (b) a federal regulator of insurance preempting state regulation of insurance (perhaps with local offices to oversee local consumer protection issues); (c) an optional federal charter (“OFC”) for insurers doing business on a national basis (covering some or all insurance regulatory issues for such insurers selecting it, in lieu of the current state-based system); (d) a federal office of insurance information to compile data, facilitate communication among regulators and coordinate responses for certain national and international issues; and (e) a financial product safety commission.¹⁸ If a federal regulator is authorized, there is some debate regarding whether such a regulator would be within the Federal Reserve, the Federal Deposit Insurance Corporation or perhaps elsewhere.

On March 26, 2009, the Treasury Department announced Administration proposals for financial regulatory reform.¹⁹ The Administration is recommending an additional “resolution authority” for

¹⁶ 2009 Charges, Government Relations Leadership Council Task Force, http://www.naic.org/committees_ex_gov_rel_leadership_council.htm.

¹⁷ In the NAIC’s view, “an entity poses systemic risk when that entity’s activities have the ability to ripple through the broader financial system and trigger problems for other counterparties, such that extraordinary action is necessary to mitigate it.” *Perspectives on Systemic Risk, Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 111th Cong. 3 (March 5, 2009) (statement of Therese M. Vaughan, Ph.D., Chief Executive Officer, NAIC) available at http://www.naic.org/documents/govt_rel_testimony_090305_vaughan.pdf. Dr. Vaughan notes that “[t]he nature of the insurance market and its regulatory structure make the possibility of systemic risk originating in the industry less than in other financial industries. In general, the insurance industry is more likely to be the recipient of systemic risk from other economic agents rather than the driving force that creates systemic risk.” *Id.* She also notes that “[s]ystemic risks originating in other parts of the overall economy, which in turn affect the insurance industry, are real. A collapse of the stock market (to a greater degree than what we have recently seen) or the bond market would have a dire effect on insurance companies and could lead to insurance company failures.” *Id.* at 4-5.

¹⁸ On March 10, 2009, S. 566, titled the “Financial Product Safety Commission Act of 2009,” was introduced in the Senate and referred to the Senate Committee on Banking, Housing, and Urban Affairs. This bill contemplates the formation of the Financial Product Safety Commission and sets forth the objectives and responsibilities of such a commission, including a charge to “minimize unreasonable consumer risk associated with buying and using consumer financial products.”

¹⁹ News Release, U.S. Department of the Treasury, “Treasury Outlines Framework For Regulatory Reform — Provides new Rules of the Road, focuses first on containing systemic risk” (March 26, 2009). See also News Release, NAIC, “Geithner Proposal Maintains State Insurance Supervision” (March 26, 2009) (responding to the Treasury Department’s proposed framework for regulatory reform and listing principles for systemic risk regulation and insurance regulatory modernization that the NAIC have outlined for Congress and the Administration, asking them to incorporate the principles, such as maintaining important responsibilities for state insurance regulators, into their proposals), available at http://www.naic.org/Releases/2009_docs/geithner_proposal.htm.

nonbank financial institutions, including insurance companies, that may pose systemic risks. Upon a “triggering determination that (1) the financial institution in question is in danger of becoming insolvent; (2) its insolvency would have serious adverse effects on economic conditions or financial stability in the United States; and (3) taking emergency action as provided for in the law would avoid or mitigate those adverse effects,” “[t]he [Treasury] Secretary and the FDIC would decide *whether to provide financial assistance to the institution or to put it into conservatorship/receivership.*”²⁰ This new resolution authority might be lodged in an existing or a new agency.

The NAIC strongly opposes federal preemption of the current state-based insurance regulatory system, emphasizing the successes of the current system at maintaining insurer solvency and consumer protections.²¹ The NAIC supports joint federal and state efforts in seeking to improve the financial regulatory system, promote financial stability and address systemic risk, however, and has offered its “assistance and expertise to Congress as it tackles the enormous challenge of developing legislative solutions to the current financial crisis.”²² In her testimony before Congress, NAIC Chief Executive Officer Dr. Therese M. Vaughan reiterated that the state-based regulatory system

²⁰ News Release, U.S. Department of the Treasury, *supra* note 19 (emphasis added). “This decision will be informed by the recommendations of the Federal Reserve Board and the appropriate federal regulatory agency (if different from the FDIC).” *Id.* Regarding conservatorship or an orderly liquidation, the Treasury Department explained that:

Depending on the circumstances, the FDIC and the Treasury would place the firm into conservatorship with the aim of returning it to private hands or a receivership that would manage the process of winding down the firm. The trustee of the conservatorship or receivership would have broad powers, including to sell or transfer the assets or liabilities of the institution in question, to renegotiate or repudiate the institution's contracts (including with its employees), and to deal with a derivatives book. A conservator would also have the power to restructure the institution by, for example, replacing its board of directors and its senior officers. None of these actions would be subject to the approval of the institution's creditors or other stakeholders.

Id.

²¹ *See, e.g.*, News Release, NAIC, “NAIC Testifies to Strength of Insurance Regulation — ‘Vigilant, Engaged, Effective’ Oversight Fosters Stability” (March 17, 2009) (describing Illinois Insurance Director Michael T. McRaith’s testimony on behalf of the NAIC at a hearing before the Senate Committee on Banking, Housing and Urban Affairs regarding Perspectives on Modernizing Insurance Regulation), *available at* http://www.naic.org/Releases/2009_docs/state_regulation_strength.htm; News Release, NAIC, “AIG: NAIC Corrects Misinformation — Policyholders Protected Under State Regulatory Authority” (March 19, 2009) (describing Pennsylvania Insurance Commissioner Joel Ario’s testimony on behalf of the NAIC at a hearing before the U.S. House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises regarding American International Group’s Impact on the Global Economy: Before, During and After Federal Intervention and emphasizing that the American International Group, Inc. (“AIG”) “Financial Products operation — not its 71 U.S. insurance subsidiaries — created the systemic risk that caused the federal government to intercede” and “AIG’s insurance companies remain strong, in part because state regulation continues to wall them off from the high-risk activities engaged in by AIG Financial Products”), *available at* http://www.naic.org/Releases/2009_docs/correcting_aig_misinformation.htm.

²² News Release, NAIC, “Systemic Risk: Focus of NAIC CEO’s Congressional Testimony — Vaughan Offers Regulatory Perspective, Assistance, Expertise” (March 5, 2009) (which includes a link to Dr. Vaughan’s testimony), *available at* http://www.naic.org/Releases/2009_docs/systemic_risk_testimony.htm.

has “a long history of consumer protection, conservative solvency oversight and market stability,” and “[a]ny system of financial stability regulation can, and must, build on this proven regime.”²³ Dr. Vaughan also emphasized certain principles that insurance regulators have developed that should be incorporated into a comprehensive systemic risk framework, including (a) preservation of a “[p]rimary role for states in insurance regulation”; (b) “[f]ormalization of regulatory cooperation and communication”; and (c) “[g]roup supervision of holding companies.”²⁴ Dr. Vaughan further explained that these “principles provide for sharing of information and formal collaboration among all financial regulators; development of best practices for systemic risk management; and preemption of functional regulatory authority only under extraordinary circumstances.”²⁵

We believe some federal regulation of insurance is likely to be part of the upcoming financial services regulatory reforms. Consideration and enactment of the Administration’s proposals announced on March 26, 2009 are likely to take months, and we expect the systemic regulator to be the first element addressed. Additionally, President Obama is expected to present an outline of the U.S. planned reforms, reflecting a consensus between the Administration and Congress, as a model for other nations at the G-20 summit in London on April 2nd.²⁶ We do not expect a new federal insurance regulatory system completely to preempt the current state-based system, however. It is most likely that a federal systemic risk regulator will be created, along with new regulations governing financial holding companies (including those with insurance company subsidiaries), to fill current regulatory gaps. Also, the OFC, a proposal that has been debated for years, is very likely at least to pass the House, but might be limited to life insurers only. Also, a financial product safety commission or similar entity is likely to be created to establish new prudential standards for the safety and soundness of financial products and the protection of consumers and investors.

Catastrophe Issues

During its March 17, 2009 meeting, the GRLC Task Force discussed, among other things, three Congressional bills regarding natural catastrophes. First, the Homeowners Defense Act of 2009 (S. 505) would establish a National Catastrophe Risks Consortium (with functions including compiling an inventory of catastrophe risk obligations held by state reinsurance funds and state residual insurance market entities, issuing securities and other financial instruments linked to the catastrophe risks insured or reinsured through members of the Consortium in the capital markets and coordinating related reinsurance contracts) and a National Homeowner’s Insurance Stabilization Program (a program to “make liquidity loans and catastrophic loans . . . to qualified reinsurance programs to ensure the solvency of such programs, to improve the availability and affordability of homeowners’ insurance, to provide incentive for risk transfer to the private capital and reinsurance markets, and to spread the risk of catastrophic financial loss resulting from natural disasters and catastrophic events”). The Homeowners Defense Act of 2009 was introduced on February 27, 2009 and referred to the Senate Committee on Banking, Housing, and Urban Affairs.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ See “International Issues” and “Also Noted,” *infra*, for further information regarding the NAIC’s role in international initiatives, including the G-20.

Second, the Hurricane and Tornado Mitigation Investment Act of 2009 (H.R. 308) would amend the Internal Revenue Code to provide to individuals and businesses in certain states a tax credit for 25% of their qualified hurricane and tornado mitigation property expenditures (such as strengthening a roof deck attachment, creating a secondary water barrier, improving the durability of a roof covering, protecting against windborne debris, etc.) up to \$5,000 for any taxable year. The Hurricane and Tornado Mitigation Investment Act of 2009 was introduced on January 8, 2009 and referred to the House Committee on Ways and Means.

Third, the Homeowners Insurance Protection Act of 2009 (H.R. 83) would authorize the Secretary of the Treasury, in consultation with the Secretary of Homeland Security, to carry out a program to improve the availability and affordability of homeowners protection coverage by providing reinsurance to qualifying state natural catastrophe insurance programs. The Homeowners Insurance Protection Act of 2009 was introduced on January 6, 2009 and referred to the House Committee on Financial Services.

Flood and Windstorm Protection

At its March 17, 2009 meeting, the GRLC Task Force also discussed the recently passed short-term extension by Congress of the National Flood Insurance Program (the “NFIP”) through September 30, 2009. The Senate and House of Representatives passed different bills in the 110th Congress that disagreed on the issue of whether to add windstorm coverage to the NFIP. The short-term NFIP extension was included in an omnibus spending bill that became law on March 11, 2009 and did not add windstorm coverage to the NFIP. On March 3, 2009, H.R. 1264, the “Multiple Peril Insurance Act of 2009,” which would “amend the National Flood Insurance Act of 1968 to provide for the [NFIP] to make available multiperil coverage for damage resulting from windstorms or floods,” was reintroduced in the House and referred to the House Committee on Financial Services.

There has been considerable debate regarding whether the NFIP should be expanded to include windstorm coverage. Proponents of such expansion have argued that it would increase the availability and affordability of windstorm coverage for consumers in certain areas of the country and reduce policy disputes over the causes of damage. Opponents of such expansion have argued that: a combination of homeowners insurance and flood coverage available through NFIP already provides consumers with sufficient coverage; the NFIP already has financial troubles that could be worsened by expanding it to cover windstorm damage; and the private insurance industry would be hurt by such expansion.

International Issues

As discussed in “NAIC Highlights — Summer 2008 National Meeting,” in June 2008, Plenary (which is comprised of the NAIC’s full membership) adopted the Solvency Modernization Initiative (“SMI”) Work Plan to analyze international solvency standards and propose related enhancements to the U.S. regulatory system.²⁷ On March 15, 2009, the Executive Committee ratified the creation

²⁷ NAIC Highlights — Summer 2008 National Meeting, *supra* note 1 at 8-9.

of the Solvency Modernization Initiatives Task Force (the “SMI Task Force”) in connection with a restructuring of the NAIC to funnel all SMI efforts through a single channel to ensure consistency. The SMI Task Force’s mission is “to coordinate all NAIC efforts to successfully accomplish the Solvency Modernization Initiative,” and specifically to address the following issues: (a) capital requirements, (b) international accounting, (c) group supervision, (d) valuation issues in insurance, and (e) reinsurance.²⁸ The SMI Task Force will analyze other financial supervisory modernization initiatives, including the European Union’s proposed Solvency II framework,²⁹ the Basel II international capital framework for banking regulation, the ongoing work by the International Association of Insurance Supervisors (“IAIS”),³⁰ solvency proposals being considered by other jurisdictions (*e.g.*, Australia, Canada and the European Union) and accounting standards being developed by the International Accounting Standards Board (“IASB”).³¹

²⁸ 2009 Charges, Solvency Modernization Initiative (EX) Task Force, http://www.naic.org/committees_ex_isftf.htm. These efforts will be coordinated with the following groups, respectively: (a) the Capital Adequacy Task Force, (b) the Statutory Accounting Principles and the International Solvency and Accounting Working Group, (c) the Group Solvency Issues Working Group, (d) the Principles-Based Reserving Working Group, and (e) the Reinsurance Task Force. *Id.*

²⁹ Dr. Therese M. Vaughan recently released her paper titled “The Implications of Solvency II for U.S. Insurance Regulation,” which she presented at the Networks Financial Institute 6th Annual Insurance Reform Summit. News Release, NAIC, “NAIC’s Vaughan Presents Paper at Insurance Reform Summit — Addresses Solvency Regulation, Capital Requirements, Lessons Learned” (March 5, 2009), available at http://www.naic.org/Releases/2009_docs/vaughan_paper_insurance_reform_summit.htm. In the paper, Dr. Vaughan describes Solvency II and summarizes the differences between it and solvency regulation in the U.S. A copy of Dr. Vaughan’s paper is available at http://www.networksfinancialinstitute.org/Lists/Publication%20Library/Attachments/132/2009-PB-03_Vaughan.pdf. See also “A Comparison of Solvency Systems: US and EU” (Draft 5/22/2008) (providing a side-by-side comparison of U.S. solvency regulation and the European Union’s Solvency II framework), available at http://www.naic.org/documents/committees_e_isawg_081206_us_eu_solvency.pdf. The International Solvency and Accounting Working Group (the “ISAWG”) explained that it has closed the comment period for this working draft, which is based on the European Union’s Framework Directive proposal, until the Solvency II Framework Directive has been officially adopted (at which time the working draft can be updated).

³⁰ Although certain commissioners have been very active working with the IAIS in the past, due to the commissioners’ obligations to their jurisdictions and various appointment and election schedules, the NAIC determined that they should have more consistent representation by the NAIC at the IAIS. Accordingly, the Executive Committee approved the appointment of Mr. George Brady, NAIC Counsel and Manager of International Relations, to the IAIS Executive Committee. Additionally, the SMI Task Force will coordinate review by, and input into, various IAIS solvency related papers by the appropriate NAIC task forces and working groups.

³¹ 2009 Charges, Solvency Modernization Initiative (EX) Task Force, *supra* note 28. On March 16, 2009, the ISAWG reported that the IASB and the Financial Accounting Standards Board (“FASB”) have committed to convergence of accounting standards for balance sheets and are working to do so, particularly in relation to insurance contracts and financial instruments. In addition, the IASB and the FASB have formed a joint Financial Crisis Advisory Group (the “FCAG”) to advise both boards regarding how to react to the current financial situation (with the IAIS having an IAIS representative present at the FCAG).

On March 16, 2009, the International Insurance Relations Leadership Group noted in its report to the Executive Committee that it has been keeping track of the efforts by the G-20 working groups on global financial regulatory reform. The U.S. Treasury has been coordinating input on these working groups from the NAIC and federal regulatory agencies.

Also Noted

Several other developments during the NAIC's Spring 2009 National Meeting are noted below.

- Life Insurance Capital and Surplus Relief. As discussed in “NAIC Highlights — Winter 2008 National Meeting,”³² the life insurance industry submitted proposals to the NAIC requesting relief from the reserve and risk-based capital standards in light of the current economic turmoil and market disruptions. On January 29, 2009, the Executive Committee voted to reject the proposals, with President Sevigny explaining that the “vote reflects [the NAIC's] belief that it is not appropriate to make emergency, permanent industry-wide changes for which the need has not been demonstrated.”³³ Rather, the NAIC is considering certain of these proposals via its normal review process, and, “[i]n the interim, current state law provides insurance regulators with the discretion necessary to supply measured relief to companies on a case-by-case basis.”³⁴ On March 15, 2009, the Capital and Surplus Relief Working Group met and, among other things, finalized its recommended charges, adding that it shall “[c]onsider any necessary changes to the NAIC process to accommodate emergency items,” however.

³² NAIC Highlights — Winter 2008 National Meeting, *supra* note 1 at 3.

³³ News Release, NAIC, “Regulators Deny Industry’s Request to Lower Capital, Surplus Standards” (Jan. 29, 2009), available at http://www.naic.org/Releases/2009_docs/capital_surplus_denied.htm.

³⁴ *Id.* For example, on March 15, 2009, the Reinsurance Task Force exposed for comments a draft reinsurance collateral guidance memo to assist commissioners in responding to proposals to consider alternative collateral arrangements due to the potentially reduced supply of letters of credit (“LOCs”) and diminished trust account balances resulting from a decline in the value of trust assets. A copy of the guidance memo is available at http://www.naic.org/documents/committees_e_reinsurance_collateral_guidance_memo.pdf. The guidance memo is intended to give guidance to commissioners of jurisdictions with laws and regulations granting the commissioners’ the discretion provided by the Credit for Reinsurance Model Act and Model Regulation (a) “to accept ‘any other form of security acceptable to the commissioner,’” and (b) “to determine that a financial institution meets the criteria to be considered a ‘Qualified U.S. Financial Institution’ for the purposes of issuing or confirming LOCs or for holding assets in trust on behalf of a U.S. ceding company.” In the guidance memo, the NAIC advises that commissioners with discretionary authority to accept alternative forms of security “should utilize this authority on a case-by-case basis only after careful and thorough evaluation of all information relevant to each situation,” and that the NAIC will consider developing a reporting mechanism to facilitate communication among NAIC members regarding acceptable alternatives forms of security. *Id.* at 1, 3. The NAIC also advises that although provisions of individual state laws corresponding to the model law may grant commissioners the authority to evaluate whether an institution is a “qualified U.S. financial institution” whose LOCs will be acceptable, “for the sake of uniformity there is a tendency among regulators to defer exclusively to the SVO for this analysis and to accept only those institutions currently included on the NAIC List of Banks when considering whether an institution is qualified to issue or confirm an LOC,” and a commissioner may require an unlisted financial institution to submit an application to the SVO for review. *Id.* at 4.

- Climate Change and Global Warming. On March 17, 2009, the Executive Committee adopted the Insurer Climate Risk Disclosure Survey (the “Climate Survey”) developed by the Climate Change and Global Warming Task Force. The Climate Survey is a “mandatory requirement that insurance companies disclose to regulators the financial risks they face from climate change, as well as actions the companies are taking to respond to those risks.”³⁵ The NAIC explained that each insurance company with annual premiums of \$500 million or more will be required to complete the Climate Survey every year and submit it to its domestic regulator, with an initial reporting deadline of May 1, 2010.³⁶ Wisconsin Insurance Commissioner Sean Dilweg recently testified on behalf of the NAIC before the Senate Committee on Commerce, Science and Transportation regarding the impact of climate change on the insurance industry and the NAIC’s efforts to address this issue.³⁷
- Credit for Reinsurance relating to Reinsurers in Run-Off. On March 15, 2009, the Reinsurance Task Force exposed for comments a proposed amendment to the NAIC Credit for Reinsurance Model Law that would authorize a commissioner with primary regulatory oversight of a multiple-beneficiary trust maintained by a reinsurer in run-off to lower the minimum trustee surplus requirement applicable to the trust.³⁸ Such a commissioner could lower by up to 50% the minimum trustee surplus from the \$20 million currently required if certain circumstances are met (including that the commissioner has found that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development). This proposed amendment reflects that a reinsurer in run-off no longer writes new business and reduces its liabilities during the run-off process, and, therefore, a portion of the \$20 million trustee surplus could be freed up for other purposes.
- Receivership and Insolvency. At its meeting on March 18, 2009, the Financial Condition (E) Committee adopted a new charge to the Receivership and Insolvency Task Force for it to “[i]dentify and recommend possible solutions to address timing and collection concerns for reinsurance recoverables by insurers in receivership,” after the Receivership and Insolvency Task Force conducted a survey and found that many of such recoverables are over 90 days past due (85.7% based on the 37 state receivers who responded to a survey, with many of these identified as delayed for various reasons such as disputes, slow pay, reinsurers in receivership and pending commutations).

³⁵ News Release, NAIC, “Insurance Regulators Adopt Climate Change Risk Disclosure — Requires Reporting of Risks, Responses” (March 17, 2009), *available at* http://www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm.

³⁶ *Id.*

³⁷ News Release, NAIC, “NAIC Testifies on Impact of Climate Change on Insurance Industry” (March 12, 2009), *available at* http://www.naic.org/Releases/2009_docs/climate_change.htm.

³⁸ The proposed language to amend the Credit for Reinsurance Model Law is available at http://www.naic.org/documents/committees_e_reinsurance_mutli_beneficiary_trust_proposal.pdf.

- Producer Licensing. At its meeting on March 17, 2009, the GRLC Task Force received an update regarding the National Association of Registered Agents and Brokers Reform Act of 2008 (“NARAB II”). NARAB II was an updated version of a prior proposal to establish a national board to oversee licensing, continuing education, and other nonresident insurance producer qualification requirements and conditions that might be adopted and applied on a multistate basis. NARAB II was passed by the House last year, but it is currently being redrafted to address perceived market legal concerns³⁹ and is expected to be reintroduced in the current Congress.

Upcoming NAIC Activities

The NAIC’s Summer 2009 National Meeting is scheduled to be held in Minneapolis, Minnesota from June 13, 2009 through June 16, 2009. In the meantime, the NAIC’s committees, task forces, and working groups continue to work on the above and other issues faced by state insurance commissioners, including through interim meetings and conference calls. The NAIC’s calendar of upcoming meetings and events is available at http://www.naic.org/meetings_calendar.htm.

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If you have any questions regarding this memorandum, please contact Leah Campbell (212-728-8217, lcampbell@willkie.com) or the attorney with whom you regularly work.

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³⁹ See, e.g., Memorandum from NAIC Legal Division to NARAB (EX) Working Group (Nov. 19, 2008) (discussing potential reciprocity issues raised by interested regulators and interested parties regarding potential reciprocity issues with NARAB II under the Gramm-Leach-Bliley Act), available at http://www.naic.org/documents/committees_ex_narabwg_nov_08_memo_add_potential_rec_issues.pdf.