NAIC HIGHLIGHTS – SUMMER 2008 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 promulgating model laws and regulations and encouraging adoption thereof by legislators and regulators). The NAIC held its Summer 2008 National Meeting from May 30th through June 2nd in San Francisco, 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

The Reinsurance Task Force's mission is, among other things, to: (1) "[p]rovide a forum for consideration of reinsurance-related issues of public policy"; (2) "[c]onsider the adequacy and appropriateness of currently applicable collateralization requirements regarding unauthorized reinsurers"; (3) "[m]onitor the development of [European Union ("EU")] reinsurance standards and prepare a comparison of the final standards with U.S. reinsurance regulatory law" and "determine what changes would be necessary to harmonize the two systems"; and (4) "[c]onsider the design of a revised U.S. reinsurance regulatory framework."[1]

Reinsurance Regulatory Modernization Framework

As discussed in our memorandum on April 8, 2008, titled "NAIC Highlights - Spring 2008 National Meeting" (the "NAIC Spring 2008 Meeting Highlights"), the NAIC previously adopted a reinsurance regulatory modernization framework (the "Framework") to reform reinsurance regulation for both domestic and foreign reinsurers. In 2006, the NAIC charged the Reinsurance Task Force with the development of alternatives to the current reinsurance regulatory system. This charge was prompted by changes in the global reinsurance marketplace and in the international regulation of reinsurance, including increased cross-border reinsurance transactions, the development of international accounting standards that incorporate requirements for increased transparency, and regional regulatory harmonization efforts such as the EU Reinsurance Directive. The Reinsurance Task Force was instructed to consult with international regulators and other interested parties in developing a proposal. The result was the Framework — an ambitious attempt to address issues arising from the multi-state regulation of reinsurance and the collateralization requirements currently imposed on foreign reinsurers. The goal of the Reinsurance Task Force is to complete the Framework by the end of 2008 and commence the implementation phase in 2009.

---

[1] 2008 Charges, Reinsurance Task Force, http://www.naic.org/committees_e_reinsurance.htm.

The Framework envisions the creation of an NAIC department to be called the Reinsurance Supervision Review Department (the "RSRD"), which would be charged with multiple functions, including assessing the regulatory effectiveness of U.S. and non-U.S. jurisdictions, determining unilateral or mutual recognition eligibility for non-U.S. jurisdictions, developing a purposes and procedures manual for U.S. regulators, and acting as a repository for relevant data concerning reinsurers and the reinsurance markets.

A memorandum, dated May 16, 2008 (the "May 16th Memo"), summarizing the issues discussed at a regulators-only meeting held from May 7 through May 9, 2008, was discussed during the Summer National Meeting. Among other things, the May 16th Memo sets forth the following points regarding the Framework:

1. The four methods of conducting reinsurance business in the U.S. under the Framework are:

    a. National Reinsurer — licensed in an approved state (its "Home State") and having a physical presence in the U.S. (available to both U.S. and non-U.S. reinsurers);

    b. Port of Entry Reinsurer — certified by a single U.S. regulator or "port of entry" ("POE") state, the reinsurer must be from an RSRD recommended non-U.S. jurisdiction, and no physical presence in the U.S. is required;

    c. Licensed, Accredited and Limited Accredited Reinsurer under the current NAIC Model Credit for Reinsurance Law; and

    d. Non-U.S. reinsurers can continue to access the U.S. market by being unlicensed and posting 100% collateral.

2. "States will be required to grant appropriate credit for reinsurance ceded by their domestic insurers to a POE reinsurer authorized by a POE supervisor." ("'Appropriate' means that the ceding insurer's domiciliary regulator retains the same authority it has under existing law to evaluate the amount of the liabilities ceded and retained in order to determine whether the contract transfers risk." In addition, no change is proposed to existing regulatory requirements relating to reinsurance credit such as the insolvency clause, U.S. choice of law, and agent for service of process.)

3. "In order to be certified as a POE reinsurer, a company/reinsurer must be domiciled and licensed under a non-U.S. jurisdiction recommended as eligible for recognition by the RSRD. Once the non-U.S. jurisdiction has been recommended as eligible, the reinsurer could then be certified to access the U.S. market through one U.S. jurisdiction. The certifying U.S. jurisdiction would be referred to as the POE state. The POE supervisor will also be governed by uniform minimum standards established by the Supervisory Board of the RSRD."

4. "National reinsurers or POE reinsurers shall have a minimum capital requirement of $250 million to be eligible to be a National Reinsurer or a POE reinsurer."

5. The POE or Home State supervisor will assign a U.S. or non-U.S. reinsurer one of five ratings based on certain factors including: ratings assigned by Nationally Recognized Statistical Rating Organizations; the reinsurer's reputation for prompt payment of valid claims; market conduct outcomes and regulatory actions; and the execution of an information-sharing and confidentiality agreement with the non-U.S. jurisdiction and the POE supervisor. For non-U.S. reinsurers, the Home State or POE will require a Form AR-1 wherein the reinsurer agrees to submit to the jurisdiction of U.S. courts and agrees to post 100% collateral if it resists enforcement of a valid, final U.S. judgment. However, a Form AR-1 will not be accepted from any reinsurer that is domiciled in a country or state that the POE supervisor or RSRD has determined does not adequately and promptly enforce valid U.S. judgments or arbitration awards.

    a. The ratings, ranking a reinsurer from 1-5, would correspond to the following collateral requirements, respectively: 0%, 10%, 20%, 75% and 100%.

6. Additionally, the Reinsurance Task Force received an update from the NAIC Legal Division regarding the constitutionality of states entering into "mutual recognition agreements" with foreign jurisdictions, an issue raised by interested parties. The NAIC Legal Division is preparing a legal opinion on the issue.

On May 31, 2008, the Reinsurance Task Force met and discussed the May 16th Memo and interested party comments that the task force has received in the interim. There was considerable discussion by interested parties seeking to clarify the relation between (a) the regulation of the reinsurer by its POE or Home State supervisor (which, among other things, would determine the reinsurer's rating and collateral requirements) and (b) the continuing regulation of the ceding company by its domestic regulator (which, among other things, would determine whether a particular transaction meets all the regulatory requirements, including contract terms and adequate transfer of risk, to be reflected as reinsurance on the ceding company's financial statements).

The Reinsurance Task Force intends to integrate the issues covered by the May 16th Memo with issues covered previously to complete and present a revised Framework (along with a comprehensive methodology for implementation of the Framework) by the end of the year. The Reinsurance Task Force plans to hold a regulator-to-regulator interim meeting from June 25, 2008 through June 27, 2008 and then an open meeting from July 23, 2008 through July 25, 2008 to finalize the comprehensive proposal.

Federal Initiatives

Although the U.S. federal government typically does not directly regulate the business of insurance, there are exceptions to this general rule when 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.

For some time, critics of the current state-based insurance regulatory system have argued that the system is unduly burdensome on U.S. and non-U.S. insurers that wish to do insurance or reinsurance business in the U.S. on a national level. The NAIC, on the other hand, historically has countered that although there are instances when federal government involvement or a national standard are necessary, the state-based insurance regulatory system provides better regulatory oversight and protection for consumers.[2]

On June 2, 2008, the Government Relations Leadership Council Task Force (the "GRLC Task Force") met. The GRLC Task Force's charges include to "[m]onitor and analyze federal and state legislative/regulatory actions regarding financial services and other issues of importance to the NAIC membership."[3]

Federal Regulation of Insurance

As discussed in the NAIC Spring 2008 Meeting Highlights, during the NAIC Spring 2008 National Meeting, the U.S. Treasury Department released a blueprint for a modernized federal structure for oversight and regulation of all financial services, including insurance. The blueprint includes a

---

[2] For example, when New York Superintendent Eric R. Dinallo testified before the House of Representatives on behalf of the NAIC, he acknowledged that "[t]he NAIC and its members believe that there are aspects of insurance oversight that require uniformity of process and harmonization of standards" and "there may be areas where federal assistance is necessary to realize objectives and standards [summarized in such testimony]" but emphasized the successes of the state-based insurance regulatory system and the advantages of having state regulators protecting insurance consumers. Superintendent Eric Dinallo, Testimony of the NAIC Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises Committee on Financial Services, United States House of Representatives regarding "Options for Insurance Regulatory Reform" at 4-5 (April 16, 2008), available at http://www.ins.state.ny.us/speeches/pdf/sp0804161.pdf. Superintendent Dinallo stressed that "[c]onsumer protection has been a hallmark of state insurance regulation" and "[o]ptional regulatory regimes [such as the proposal for an optional federal charter] lead to regulatory arbitrage and gaps in oversight." *Id*. at 3. Accordingly, Dinallo proposed that that "any entity created to implement reforms or uniform standards should be developed and implemented by state regulators" who "should both set the standards and enforce compliance" and such an entity "should be the primary U.S. contact for coordination with international insurance regulators." *Id*. at 4-5. *See also infra* note 5 (summarizing Illinois Insurance Director Michael T. McRaith's testimony on behalf of the NAIC regarding H.R. 5840, the Insurance Information Act of 2008).

[3] 2008 Charges, Government Relations Leadership Council Task Force, http://www.naic.org/committees_ex_gov_rel_leadership_council.htm.

proposal for the creation of an optional federal charter (an "OFC") to streamline insurance regulatory requirements for industry participants doing business on a national basis.[4]

On April 17, 2008, H.R. 5840, the Insurance Information Act of 2008, was introduced in the House of Representatives. This bill would establish an Office of Insurance Information (the "OII") within the Department of the Treasury to (a) collect data and issue reports regarding insurance (except health insurance), (b) establish federal policy on international issues, and (c) advise the Secretary of the Treasury on major domestic and international insurance policy issues. Additionally, the bill provides that if any state laws are inconsistent with federal policy on international insurance matters set forth in an agreement between the U.S. and a foreign government or regulatory entity, such state laws are preempted. The House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing on June 10, 2008 to consider H.R. 5840.[5]

Flood Insurance

Unless it is reauthorized, the National Flood Insurance Program (the "NFIP") is due to expire on September 30, 2008. On June 2, 2008, the GRLC Task Force discussed, among other issues, the differences between the reauthorization bills that have been passed by the Senate and the House (S. 2284 and H.R. 3121, respectively). Some of those differences are: (a) the Senate bill forgives existing NFIP debt, whereas the House bill does not; (b) the House bill includes optional wind coverage, whereas the Senate bill does not; and (c) the House bill increases coverage limits, whereas the Senate bill does not.

---

[4] The creation of an OFC has been the subject of continuing debate. For example, the National Insurance Act of 2006 and the National Insurance Act of 2007 each included OFC proposals and were heavily debated in the House and Senate. See also, Dinallo, *supra* note 1 (discussing that although the NAIC supports certain regulatory reforms, it opposes creation of an OFC).

[5] Illinois Insurance Director Michael T. McRaith testified before the House Subcommittee on behalf of the NAIC, providing conditional support for H.R. 5840. News Release, NAIC, "NAIC Offers Conditional Support for Establishing Office of Insurance Information" (June 10, 2008), available at http://www.naic.org/Releases/2008_docs/treasury_ins_info_office.htm. In particular, Director McRaith stated that "State insurance regulators support the narrow objectives of (1) allowing a federal agency to work with state insurance regulators to receive and analyze industry data; and (2) establishing a central point of contact in the federal government for foreign governments regarding international insurance matters." Testimony of the NAIC Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises Committee on Financial Services, United States House of Representatives, Regarding "H.R. 5840, the Insurance Information Act of 2008" at 3 (June 10, 2008), available at http://www.naic.org/documents/govt_rel_testimony_0806_mcraith.pdf. However, the NAIC's support is "conditional" in that (a) it "hinges on the proposal not changing in ways detrimental to insurance consumers as it winds its way through the legislative process" and (b) "State regulators would object to the OII or any other Federal entity having the authority to preempt consumer protections and solvency standards adopted by States." *Id.* at 3, 5. As an example of how such preemption might occur, Director McRaith explained that "insurance regulators oppose the notion that the OII can enter into an 'agreement' with a foreign government and then, through the terms of that agreement, impose upon all States an industry practice or standard that threatens essential consumer protections." Id. at 3.

Surplus Lines

There appears to be some consensus that surplus lines (also known as excess lines) insurers and brokers doing business in multiple states or nationwide would benefit from uniform licensing and regulatory requirements. Also, licensees and the states would benefit from a clear and uniform method for the allocation of premium taxes among states for insurance covering multi-state risks. However, the best approach to achieving uniform standards has been debated for many years. Accordingly, the Surplus Lines Task Force's mission is "to monitor the surplus lines market and its operation and regulation, including the activity and financial condition of U.S. and non-U.S. surplus lines insurers by providing a forum for discussion of issues and to develop or amend model regulation."[6] In addition, the Surplus Lines Task Force was instructed to "[c]onsider a uniform method of allocating surplus lines and independently procured insurance premium tax on multi-state risks and any other surplus lines issues," and this task was deemed "essential."[7]

On May 31, 2008, the Surplus Lines Task Force met and discussed ways in which uniformity might be brought to the surplus lines market. First, the task force received a report from NAIC staff on the status of two versions of the "Nonadmitted and Reinsurance Reform Act of 2007" (the "NRRA") currently pending in the Senate (S. 929, which was introduced in the Senate on March 20, 2007 and referred to the Senate Committee on Banking, Housing, and Urban Affairs, and H.R. 1065, which was adopted by the House of Representatives on June 25, 2007 and referred to the same Senate Committee). As discussed in the NAIC Spring 2008 Meeting Highlights, the NRRA is an act created to streamline the regulation of nonadmitted insurance, surplus lines insurance and reinsurance by setting forth certain federal standards and certain limits on state regulations. If either bill is enacted in its current form, the NRRA would (i) grant sole regulatory authority with respect to the placement of nonadmitted insurance to the policyholder's home state; (ii) limit states to uniform standards for surplus lines eligibility in conformity with the NAIC Nonadmitted Insurance Model Act; (iii) establish a streamlined insurance procurement process for exempt commercial purchasers by eliminating the requirement that brokers conduct a due diligence search to determine whether the insurance is available from admitted insurers; (iv) establish the domicile state of the ceding insurer as the sole regulatory authority with respect to credit for reinsurance and solvency determinations if such state is an NAIC-accredited state or has financial solvency requirements substantially similar to those required for such accreditation; and (v) require that premium taxes related to nonadmitted insurance be paid only to the policyholder's home state, although the states may enter into a compact or establish procedures to allocate such premium taxes among the states.

Second, the Surplus Lines Task Force received a presentation by Steve Stephan (National Association of Professional Surplus Lines Offices, Ltd.) and Daniel Maher (Excess Line Association of New York) on the status of the draft Surplus Lines Insurance Multi-State Compliance Compact ("SLIMPACT"). As an interstate compact, SLIMPACT would impose

---

6 2008 Charges, International Solvency and Accounting Working Group, http://www.naic.org/committees_e_isawg.htm.

7 2008 Proposed Charges (Adopted by Plenary on 12/4/07), 22 (Dec. 3, 2007), available at http://www.naic.org/documents/committees_Charges.pdf.

requirements on those states entering into the compact. However, SLIMPACT would include both (a) mandatory provisions, which each state entering into the compact would be required to adopt and (b) uniform standards, which would be adopted if two thirds of the compacting states agreed to them, yet would be non-mandatory (thus allowing any compacting state to opt out of a particular uniform standard). Some examples of mandatory provisions are: (a) a surplus lines broker placing a multi-state risk would be subject only to compliance with the laws of the home state of the insureds; (b) uniform premium tax allocation formulas would be imposed such that each state could collect its portion based on its tax rate applied to the portion of the premium allocated to such state; and (c) creation of a facility or clearinghouse for multi-state surplus lines lists, which would include a web interface to allocate the premium for a surplus lines broker placing a policy, collect information, and provide reports to the parties and the states so that all parties would know what is owed to each state). An example of a non-mandatory uniform standard is the requirement for notice on a policy issued by a surplus lines insurer. Although it was noted that most states impose such a requirement and it would simplify compliance if such requirements were uniform, a compacting state could opt out of the uniform standard and impose its own regulatory requirements.

The Surplus Lines Task Force and presenters also discussed the following: the differences between the NRRA and SLIMPACT (e.g., the different definition of "home state" and the fact that the NRRA leaves open the issue of how the states shall establish procedures to allocate premium taxes), the feasibility of creating a clearinghouse to track surplus lines placements and allocations of premiums as a stand-alone proposal, and alternative ways for the states to comply with the NRRA if it passes (e.g., by entry into an interstate compact such as SLIMPACT, development and adoption of NAIC model laws, and/or establishment of a facility or clearinghouse for policies placed on a surplus lines basis).

Either the NRRA or SLIMPACT could be adopted exclusively and operate independently of the other. However, if both are adopted, amendments would be required to allow them to operate together.

International Issues

Solvency II

Certain insurers and reinsurers do business internationally, and the NAIC has been tracking international developments and endeavoring to harmonize U.S. and international standards to facilitate cross-border business (e.g., the reinsurance regulatory modernization framework discussed above). As discussed in the NAIC Spring 2008 Meeting Highlights, the NAIC has been keeping particularly close track of the European Commission's continuing development of Solvency II, a proposal to revamp the EU's solvency system. The Solvency II proposal is currently being considered by the European Parliament and European Council. If the proposal is adopted, implementation measures are expected to be developed in 2009 or 2010, with the new framework potentially becoming effective in 2012.

There are some significant differences between the Solvency II proposal and the current U.S. state-based system, including (a) the accounting systems recognized, (b) the applicable capital requirements for insurer solvency, and (c) the regulation of entire company groups under Solvency II (as opposed to U.S. state regulation of insurance companies only). First, Solvency II is expected to adopt international accounting standards, whereas U.S. insurer solvency is currently governed by codified statutory accounting principles developed by the NAIC. Second, Solvency II allows the use of internal company models to determine capital requirements (with prior approval) and provides for a group supervisory system (including allowing guarantees by non-insurer parent companies to bolster insurer solvency, thus requiring only minimal capital to be kept at the insurance company level). By comparison, the current U.S. insurance regulatory system governs only the insurance company members of an insurance holding company system and determines insurer solvency based on the capital held by the insurer itself (and closely scrutinizes transactions that would transfer assets from an insurer to another member of its insurance holding company system).

On May 31, 2008, the International Solvency and Accounting Working Group (the "ISA Working Group") met. The ISA Working Group's charges provide that it shall (i) monitor the developments of the International Association of Insurance Supervisors (the "IAIS") and the International Accounting Standards Board (the "IASB") as they relate to insurance accounting issues and (ii) monitor the joint convergence projects of the IASB and the Financial Accounting Standards Board (the "FASB"), which include efforts to bring U.S. and international accounting standards into accord.[8] Among other things, the ISA Working Group (a) heard a presentation on the European group supervision model proposed by Solvency II (including allowing groups, upon supervisory approval, to use internal models to determine regulatory capital requirements for the group as a whole, and for each individual member thereof); (b) discussed current activities of the FASB and the IASB (noting the possible announcement that the U.S. will adopt International Financial Reporting Standards in 2013 and acknowledging that, if so, the FASB likely would cease to exist in its current form); and (c) distributed a draft document comparing the features of the current U.S. regulatory regime and the European solvency system proposed to be implemented by Solvency II for review and comments by the ISA Working Group.

At the NAIC's Spring 2008 National Meeting, the International Insurance Relations Committee asked the NAIC staff to develop a work plan dividing Solvency II into sections so that experts could be assigned to monitor Solvency II as it continues to progress and as implementing legislation is developed, thus enabling the NAIC to better anticipate how Solvency II will affect the U.S. insurance industry. On June 2, 2008, the Plenary Committee adopted the International Insurance Relations Committee's report and proposed initiative. The NAIC then announced that it had adopted the "Solvency Modernization Work Plan, which will analyze international solvency standards and propose related enhancements to the U.S. regulatory system."[9] For example, the

---

[8] 2008 Charges, International Solvency and Accounting Working Group, http://www.naic.org/committees_e_isawg.htm.

[9] News Release, NAIC, "Regulators Adopt Solvency Work Plan" (June 2, 2008), available at http://www.naic.org/Releases/2008_docs/regulators_adopt_solvency.htm.

work plan (a) "compares the long-standing U.S. risk-based solvency system with the European Union's proposed new Solvency II framework, which introduces a risk-based approach to solvency in Europe" and (b) "analyzes the potential impact that Solvency II might have on U.S. insurers, focusing on the following areas: capital requirements; international accounting; group supervision; valuation issues; and reinsurance."[10]

The IAIS and Mutual Recognition of Reinsurance Supervision

As discussed in the NAIC Spring 2008 Meeting Highlights, the IAIS has been working on a draft Guidance Paper on the Mutual Recognition of Reinsurance Supervision, which is intended to facilitate cross-border reinsurance by allowing jurisdictions to recognize other jurisdictions where regulation and supervision is equivalent, comparable, or otherwise acceptable. The NAIC works with the IAIS[11] and has been continuing to monitor the development of this paper. At its meeting on June 1, 2008, the International Insurance Relations Committee discussed the fact that the IAIS has completed drafting the guidance paper and has referred it to its Technical Committee. The guidance paper is expected to be exposed at the national meeting of the IAIS, which will take place in Budapest, Hungary, from October 14, 2008 through October 17, 2008.

Restructuring Mechanisms for Troubled Companies

On May 30, 2008, the Restructuring Mechanisms for Troubled Companies Subgroup of the Financial Condition Committee (the "Subgroup") met. The Subgroup's charges include that it shall (i) undertake a study of solvent schemes of arrangement and Part VII Portfolio transfers (transfers leaving no recourse to the original contractual obligors/insurers) employed in non-U.S. jurisdictions in order to evaluate their potential effect on claims of domestic insureds and on the solvency of U.S. insurers and (ii) consider best practices for U.S. insurance regulators to the extent they employ solvent schemes of arrangement or interact with foreign regulators that have implemented such schemes.[12]

The Subgroup discussed a draft outline for a white paper to be developed, titled "Restructuring Mechanisms for Troubled Companies," to set forth information on the types of mechanisms available to state insurance regulators with respect to troubled companies and run-off operations. The outline indicates that the white paper will be limited to situations where an insurer is in a

---

10 *Id.*

11 In particular, the NAIC's International Insurance Relations Committee "supports the work of the IAIS by participating in [the IAIS's] Executive, Technical and other relevant Committee meetings"; "drafting and commenting on papers that deal with international solvency supervision, accounting standards, reinsurance regulation and other issues of regulation of the business of insurance"; "attend[ing] the IAIS annual conference and interim meetings"; and "present[ing] information on relevant topics at regional training programs." http://www.naic.org/topics/topic_iais.htm.

12 2008 Charges, Restructuring Mechanisms for Troubled Companies Subgroup, http://www.naic.org/committees_e_restructuring.htm.

financially troubled condition that could lead to an insolvency in the foreseeable future, not to situations where an insurer is merely troubled by a particular book of business.

In response to certain interested party comments, the Subgroup agreed to incorporate certain additional concepts into the white paper (e.g., describing in the background section of the white paper other mechanisms available to insurers before they become "troubled companies," noting pros and cons and public policy considerations in connection with various mechanisms to be discussed in the white paper, and providing historical examples). The Subgroup requested that the NAIC staff begin drafting certain miscellaneous and background sections of the white paper. The Subgroup intends to begin by focusing on the "Run-off of Existing Blocks" mechanism, and invited interested parties to submit in-depth comments on this subject.

Climate/Catastrophe Issues

Climate Change White Paper

On May 31, 2008, the Climate Risk Disclosure Working Group (the "Climate Working Group") adopted, with certain amendments, a white paper titled "The Potential Impact of Climate Change on Insurance Regulation." Among other issues, the white paper discusses (a) the effects of climate change on an insurer's investments and solvency (e.g., risks of direct and indirect investments in real estate, new investment opportunities in goods and services that reduce greenhouse gas emissions, and hedging against catastrophic events by investing in commodities needed in the event of such catastrophes); (b) the need for additional analysis and development of regulatory tools to address an insurer's exposure to catastrophes and climate change (e.g., geographic distribution of property exposures, use of catastrophe modeling, liquidity issues that may arise in the face of catastrophic losses, and the use of catastrophe insurance, catastrophe bonds and other instruments to manage an insurer's risks); (c) the benefits of mitigation efforts (e.g., improved building codes, increased consideration in land-use planning of the risks associated with new home developments in certain high-risk areas, and programs to increase consumer awareness of severe weather risks and ways to protect their homes against catastrophic events); (d) certain ways that an insurer can provide innovative products and financial incentives to encourage changes in policyholder behavior (e.g., offering premium benefits for those living in areas with more robust building codes, retrofitting homes to protect against catastrophic events, using more fuel-efficient vehicles, driving less, upgrading buildings with environmentally friendly products when rebuilding after a loss, etc.); (e) the role of the federal government (e.g., proposed reforms to the National Flood Insurance Program, disaster mitigation grants and loans, a federal policy to reduce greenhouse gasses, and the creation of a new federal agency to address climate change); and (f) disclosures by insurers regarding climate risk (which are currently being discussed in further detail, as summarized below).

Certain interested parties reiterated their concerns that, although there may be some consensus that climate change is occurring, there is disagreement regarding the effects of such change, and thus they objected to adopting the white paper as written (and regarding the disclosure requirements in particular). Members of the Climate Working Group responded that the white paper is intended to indicate issues for further consideration and suggested that the white paper is broad enough and avoids particularly controversial statements. The Climate Working Group recommended the

amended white paper for adoption, and it was adopted by the NAIC's Plenary Committee on June 2, 2008.[13]

Climate Risk Disclosure

As discussed in the NAIC Spring 2008 Meeting Highlights, the Climate Task Force heard panel discussions from industry associations on a prior draft of a Climate Risk Disclosure Proposal (the "Disclosure Proposal") at the Spring 2008 National Meeting. The Disclosure Proposal is intended to impose new disclosure requirements on insurers so that they will provide regulators with information regarding the insurers' assessments of, and planned responses to, the effects of climate change. At the Spring 2008 National Meeting, the panels raised concerns regarding the Disclosure Proposal, including the following: (a) whether the disclosure of confidential proprietary information to regulators would be required (and, if so, whether it would be kept confidential from the public), (b) whether requiring the disclosures might lead to increased litigation risks for insurers, (c) whether the disclosures are intended to gather information or to cause insurers to change their practices, and (d) where the disclosures should be required (e.g., in annual statement interrogatories, Management Discussion and Analysis (MD&A) disclosures or elsewhere).

Incorporating certain comments raised by the panels and interested parties in the interim, on May 31, 2008, the Climate Task Force and Climate Working Group exposed a revised draft of the Disclosure Proposal for additional written comments to be received by June 30, 2008. However, the revised Disclosure Proposal notes certain open issues for further discussion (relating in particular to (a) the appropriate venue for collection of the disclosures and (b) whether responses to a particular question should be public or confidential to regulators).

If the Disclosure Proposal were adopted in its current form, the disclosures would be submitted as a supplement to an insurer's annual statements (rather than in more formal annual statement interrogatories, as discussed at the Spring Meeting). For 2009, such disclosures would be mandatory for an insurer writing premiums over $100 million, but voluntary for all other insurers. For 2010, such disclosures would be mandatory for an insurer writing premiums over $1 million, but voluntary for all other insurers.

Upcoming NAIC Activities

The NAIC's Fall 2008 National Meeting will be held in Washington, D.C., from September 22 through September 24, 2008. 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.

---

[13] News Release, NAIC, "Climate Change Study Focuses on Insurance Impact" (June 2, 2008), available at http://www.naic.org/Releases/2008_docs/climate_study.htm.

* * * * * * * * * * * * * * *

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.

This memorandum was authored by Leah Campbell and Marshal Bozzo.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

June 12, 2008