pennsylvania
INSURANCE DEPARTMENT

MEMO

ATTENTION: Chief Executive Officers or Presidents of All Domestic Insurers

FROM: Stephen J. Johnson, CPA
Deputy Insurance Commissioner

DATE: December 16, 2014

RE: **Developments in Financial Regulatory Items for 2015**

This memorandum highlights recent developments in activities relating to the financial regulation of domestic insurers. Please pass this information on to members of your staff responsible for compliance with corporate and financial reporting requirements.

REGULATORY ITEMS

1. Invite the Regulator to Meet Your Board of Directors

The regulation of insurance is undergoing a seismic shift in approach both in this country and around the world. Under this new regulatory approach, the Board of Directors will now have an enhanced role and active participation in the reporting process. It is critical that Board members, both at the insurance company and holding company levels, understand these fundamental changes. Because of the importance of these changes and their impact on insurance company governance, I am making myself available to meet with the Boards of Pennsylvania domestic companies to discuss the impact of this changing regulatory landscape. Please contact my office, and I will make every effort to make my schedule work with your Board calendar. I have now attended some 50 Board meetings and found my presentation and the Q & A session that follows to be well received.

2. Risk-Based Capital (RBC)

It is the Department's expectation that a domestic insurer actively writing new policies should have a RBC ratio of at least 300%. These expectations come from the logic that if an insurer is above 300%, it cannot ever fall under the Trend Test RBC. The Department will continue to request corrective action plans from any active domestic insurer with a RBC ratio below 300%.

3. Complaint Reconciliation Tool

The Department encourages you to utilize the complaint reconciliation tool to list and verify closed complaint information we have recorded against your company. The information to be verified includes the name of the specific underwriting company and type of coverage for each individual complaint. Companies can locate this tool through the Department's website www.insurance.pa.gov by clicking on the "Services for Insurance Companies" portal and choosing "Doing Business in Pennsylvania." Should you have any questions regarding this new tool, please contact Carolyn M. Morris, Bureau of Consumer Services at (717) 783-9862 or camorris@pa.gov.

4. Group Supervision

The financial meltdown has taught regulators that reputational risk can bring down an organization and as such we need to better understand all the material risks within any legal entity of a Group that could affect the insurance company(s) within the Group. Going forward, you will see the Department requesting more information both from the analysis and examination functions about the Group, its corporate structure (understanding all the companies that are within a Group), risks, strategies, governance and financial condition. This could include interaction with the Board of Directors or Audit Committee at the ultimate parent level. There is increased coordination between state regulators who have companies within a Group. There is also increased interaction with both domestic and international regulators through supervisory colleges.

5. Enterprise Risk Report – Form F

Material changes were made to the NAIC Insurance Holding Company System Model Act and Regulation as part of state insurance regulators response to the financial meltdown. Pennsylvania adopted these revisions in 2012. These changes included the filing of an Enterprise Risk Report (Form F) on or before March 31, 2015 (and each year thereafter). The Form F has a list of questions that describe the risks to your specific holding company system. You should take the time and be thorough and thoughtful with your responses.

On May 16, 2014, within the Pennsylvania Bulletin the Department issued final regulatory changes to our regulation for Holding Companies, Chapter 25. This includes the actual Form F itself and other important changes.

6. Corporate Governance

The NAIC is working on a yearly disclosure of a company's corporate governance framework and practices. The proposed disclosure can be found on the NAIC's website. The NAIC has adopted a Model Law and Regulation to make such disclosure a requirement and to give it confidential treatment. It is the Department's goal to adopt the NAIC's Model Law and Regulation in 2015 for an effective date of 1/1/16.

The NAIC has exposed changes to its Model Audit Rule to add a requirement for companies with greater than $500 million in direct written premiums to have an internal audit function. Once adopted by the NAIC it is the Department's goal to amend our regulation, Chapter 147, in 2015

7. Risk-focused Financial Examinations

The risk-focused examination process requires a top-down approach, and includes interviews with C-level and other executive management as well as selected Board members. To be performed as efficiently as possible, the risk-focused examination process requires a collaborative effort on the part of the Department, the insurer and the insurer's independent certified public accountant (CPA). Guidance for how to prepare for a risk-focused examination is posted on the Department's web site at:

http://www.portal.state.pa.us/portal/server.pt/community/doing_business_in_the_commonwealth/9264/risk_focused_financial_examinations/631750

As recommended in the guidance, I urge you to purchase the NAIC's *Financial Condition Examiners Handbook* to gain an understanding of the entire process.

This process will be used to verify and comment on (mostly through the management letter) your Corporate Governance and Enterprise Risk Management Processes as well as your organizations prospective risks.

As the Commonwealth has been reducing staff complements in all agencies to keep the cost of government in line with revenues, our complement at the Insurance Department has been reduced as well. This has necessitated the Department to use more vendors to assist us in the financial examination process. In many cases, vendors will be used for the first time on examinations in the future. The Department has worked hard with our vendors and the companies to make the examination process as efficient and cost-effective as possible. I encourage companies to work closely with the Department to keep the cost of examinations to a reasonable level, with the understanding that the law mandates an examination be conducted at least once every five years. The risk-focus examination process is more of an operational exam rather than just a financial examination; therefore, the initial cost of the risk-focus exam is higher than past financial exams. It is the Department's goal to have such cost stabilized with the performance of the second risk-focus exam on your company.

8. Insurer Investment Custodial Agreements

On many financial examinations the Department has seen that companies either amend their custodial agreements or change custodians. These changes have created non-compliance issues with the Department's regulation, Chapter 148a, Safeguarding Insurance Securities. Companies that make such changes need to make sure the new or amended agreement is in compliance with Chapter 148a before executing such agreement.

9. Requests for Meetings with Insurer Management

My general practice is to meet with representatives of each domestic insurer at least once every five years to discuss the insurer's results from operations and future plans. Such meetings will be held in the year of the next examination (i.e., meet in 2015 if your next exam is as of 12/31/15). A number of insurers, some for the first time, may receive requests for these informational meetings in 2015. Please be assured that these requests are not an indication that the Department has identified any solvency or compliance concerns but are intended to allow the Department to gain a better understanding of the operations of all domestic insurers. It is very helpful to have a presentation similar to what is prepared for meetings with rating agencies provided in advance of these meetings to share with the Department. Some examples of topics to be included for discussion are significant operational results, future business plans and your Enterprise Risk Management Process.

10. Coordination of Multi-State Licensing

In Department Notice No. 2004-10, all domestic insurers were advised to notify the Department of any efforts to expand operations in other states. Such efforts may include applications to become licensed, expand existing licensing authority, or to transact surplus lines or reinsurance business in other states. Notice of these types of activities is needed to facilitate coordination among state regulators and streamline multi-state licensing functions. Notices should be emailed to: stjohnson@pa.gov no later than the date the applications are filed.

11. Contact Information

Please ensure that the Department is provided with prompt notice of any changes in statutory home office address, mailing address or other contact information for your insurer. Failure to provide the Department with current contact information causes unnecessary delays and expense for both the Department and insurers in efforts to communicate or respond to requests for information. Notice of changes in contact information or any questions about the types of information required by the Department should be directed to Kim Rankin, Director, telephone: 717.783.6409, fax: 717.787.8557, email: krankin@pa.gov. The form for the notice may be accessed at:

http://www.naic.org/industry_ucaa_corp_amend.htm#section6.

12. Confidential Information

We at the Department understand the importance of protecting confidential information received from our companies. To have an open dialogue, our companies must feel confident that information will be protected. It has always been the Department's policy to protect such information to the fullest extent of the law including by and through litigation if necessary. In my 24 years at the Department there has never been a release of confidential information from my area of responsibility.

13. Name Changes

If you are considering a name change of your insurance company you first need to contact the Department and review the procedures. **DO NOT** file anything with the Department of State until you have had a discussion with the Insurance Department.

14. Credit for Reinsurance Law

At its November 2011 Fall Annual Meeting, the NAIC adopted amendments to its Model Credit for Reinsurance Law which allow for reduced collateral for reinsurers that are financially solvent and licensed in a jurisdiction that has a well defined regulatory framework. Pennsylvania adopted these changes via Act 136, effective on July 5, 2012. Act 136 amended 40 P.S. §442.1 to provide the Commissioner the authority to "certify" reinsurers so that ceding insurers may receive credit for reinsurance ceded to duly certified reinsurers. On June 29, 2013, the amendments to chapters 161 and 163 of the Department's regulations which outline in detail the procedures to become a certified reinsurer became effective.

The Department is now accepting applications to become a certified reinsurer. The Department is working in coordination with the NAIC's Reinsurance Task Force on the designation of the jurisdiction and with the Reinsurance Financial Analysis Working Group to allow "passporting" of companies that have been certified in another state.

15. Business Corporation Law

On October 22, 2014 the Governor signed into law amendments to the Business Corporation Law, Title 15 (Act 172 of 2014). The one amendment specific to insurance was the ability of HMO's to form as LLCs.

16. Receivership Law

On October 14, 2014 the Governor signed into law amendments to the Insurance Department Act (Act 144 of 2014) giving certain preferences to the Federal Home Loan Bank under our receivership laws.

FINANCIAL STATEMENT FILING REQUIREMENTS

1. Filings relating to Insurance Holding Company Systems

As permitted under 31 Pa. Code, §25.13(a) (relating to forms—incorporation by reference, summaries and omissions) documents required to be filed with Form B (annual registration statements) including biographical affidavits, cost-sharing agreements, reinsurance agreements, guarantees, etc., may be incorporated by reference if the documents are currently on file with the Department and there have been no changes to the filed documents within the immediately preceding three years. Annual Form B filings should include any documents that have been on file with the Department for more than three years whether or not the documents have changed. Please remember that filing fees are due with the submission. The Department is no longer invoicing after the submission.

2. Late Filing Penalties for Required Financial Filings

The timely receipt of required filings is fundamental to the success of the Department's financial regulation program. I recognize that unforeseen or unusual circumstances may delay the filing or receipt of financial statements and related filings and, upon request, may allow a short grace period beyond the due date for receipt of late filings. However, insurers will be charged a late-filing penalty up to $200 per day as authorized under 40 P.S. §443(e)(1) and/or 40 P.S. §991.1410 and may also be subject to other penalties as provided by law if filings are not made within the required time period.

3. Own Risk and Solvency Assessment (ORSA)

I have continued to participate in the NAIC's efforts to develop requirements for large insurers to file an ORSA with domestic regulators. The ORSA will assist state regulators in better understanding a company's risk management system, how it monitors such risks and the capital required for such risks. The Model developed by the NAIC would require an insurer or insurance group to maintain a risk management framework, to complete an ORSA and an ORSA Summary Report, and would provide confidentiality protections for the same. House Bill #1481, which included the ORSA requirement, was signed into law by the Governor on October 25, 2013. The legislation has an effective date of January 1, 2015 (with the first ORSA filed during 2015).

The NAIC has developed and subsequently amended an ORSA manual for companies to follow as they prepare their ORSA. This manual is written on a principals based methodology. In addition the NAIC has done over the past two years an ORSA Pilot Program to access such filings submitted on a voluntary basis by certain companies. The results of those reviews are posted on the NAIC's website. It is critical that you review such document before finalizing your ORSA submission to the Department in 2015.

LEGISLATION AND REGULATORY INITIATIVES

1. Standard Valuation Law Principle Based Reserving

At its November 2012 Fall Annual Meeting the NAIC adopted changes to the Valuation Manual. This will allow states to move to adopt the amendments to the Standard Valuation Law. The amendments will provide the life industry the ability to reserve utilizing a principle based methodology for prospective business. It is the Department's goal to adopt this change in 2015. The changes would not be effective until 42 states representing at least 75% of the direct written premium in the United States have adopted these changes.

2. NAIC Mortgage Guaranty Model Law

The NAIC is in the process of amending the Mortgage Guaranty Model Law to improve the oversight of such entities on lessons learned from the 2008/2009 Financial Meltdown. Pennsylvania is a member of the NAIC Working Group that is tasked with this charge. It is the Department's goal to adopt this change in 2015.

Questions concerning this memorandum may be directed to:

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I encourage companies to be pro-active with the Department and dialogue often on issues or events affecting your company.