

ATTENTION Chief Executive Officers or Presidents
of All Domestic Insurers

FROM Stephen J. Johnson, CPA *MD*
Deputy Insurance Commissioner

DATE December 9, 2011

RE **Developments in Regulatory Items and Financial
Statement Filing for 2012**

This memorandum is a supplement to the Department's filing instructions and highlights recent developments in financial statement filing requirements and other 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. With the Board meetings I have attended to date I found them to be well received.

2. NAIC's Solvency Modernization Initiative (SMI)

The Solvency Modernization Initiative (SMI) is a critical self-examination in our continuous effort to look for improvements in the U.S. insurance financial regulation framework. The U.S. financial regulatory system, using general authority and exception-based rule setting (vs. a detailed/explicit authority based system), has been utilized for years and has been very effective and successful, without the need for intrusive regulation. U.S. regulators support improving on an already-good situation, where the cost of regulation is reasonable and not excessive, rather than starting from scratch with all new and yet-to-be proven theories.

The Initiative is examining five areas: Capital Requirements, Governance and Risk Management, Group Supervision, Statutory Accounting and Financial Reporting and Reinsurance. Many of these Initiatives could have a material impact to your operations. It is imperative that you follow the activities to be prepared for change.

3. Risk-Based Capital (RBC)

It is the Department's expectation that a domestic insurer actively writing new policies should have an RBC ratio of at least 300%. The Department will continue to request corrective action plans from any active domestic insurer with a ratio below 300%.

4. Risk Focused Financial Examinations

The risk focused examination process requires a top-down approach, including interviews with C-level and other executive management as well as selected board members. To be performed as efficiently as possible, the risk-focused 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_common_wealth/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.

5. 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. A number of insurers, some for the first time, may receive requests for these informational meetings in 2012. 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 list of significant operational results and future business plans prepared in advance of these meetings to share with the Department.

In addition, all insurers scheduled for on-site financial examinations as of year-end 2012 will receive a request to meet during 2012.

6. 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. These activities 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.

7. 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 Robert E. Brackbill, Chief, Company Licensing Division, telephone: 717.783.2143, fax: 717.787.8557, email: rbrackbill@pa.gov. The form for the notice may be accessed at:

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

8. Department's Web Site

The Department's web site was redesigned in 2010 as part of a Commonwealth-wide initiative. I hope you find it helpful and would appreciate any recommendations for future enhancements. Please note the Department's website address has changed to www.insurance.pa.gov. Additionally, our e-mail address extensions have also been changed from "state.pa.us" to "pa.gov".

FINANCIAL STATEMENT FILING REQUIREMENTS

1. Changes to Statutory Accounting Principles (NAIC Accounting Practices and Procedures Manual)

Income Taxes

SSAP No. 101 (effective January 1, 2012) which permanently allows the expansion of deferred tax assets to the 3 years and 15% that was in SSAP 10-R with new limitations. Please review this carefully prior to your implementation.

Accounting for Transferrable and Non-Transferrable State Tax Credits

SSAP No. 94-R (effective December 31, 2011) has been expanded to allow Pennsylvania state tax credits purchased by Pennsylvania domestic insurance companies to be admissible as an asset.

2. 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 3 years. Annual Form B filings should include any documents that have been on file with the Department for more than 3 years whether or not the documents have changed.
- The NAIC's initiative to enhance state oversight of insurance holding company systems includes a greater emphasis on the ongoing analyses of insurance holding company systems, including the financial statements of ultimate controlling person(s). (See Form B, Item 8. Financial Statements and Exhibits.) The financial statements are required to be filed as attachments to the annual Form B filing unless an extension is granted under §25.14 (relating to information unknown or unavailable and extension of time to furnish).

3. 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 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 may also be subject to other penalties as provided by law if filings are not made within the required time period.

4. Enterprise Risk Management Reports

Rating services require insurers to submit to an Enterprise Risk Management (ERM) process as part of reviews for assignment of financial strength or credit ratings. ERM results are a valuable tool in the Department's efforts to construct an integrated risk-focused process for all solvency monitoring and financial regulation activities. Therefore, please continue to send to my attention a copy of any ERM reports provided to a rating service for your insurer. The copy should be clearly marked "Confidential," and the Department will maintain its confidentiality under 40 P.S. §443(d).

LEGISLATIVE AND REGULATORY INITIATIVES

1. Risk-Based Capital (RBC) for Life and Health Insurers and Fraternal Benefit Societies

The NAIC's Health RBC instructions include a trend test calculation, and the NAIC RBC for Health Organizations Model Act has a trend test component in the definition of "company action level event." Pennsylvania's RBC statutes for other types of life or health and property or casualty insurers already include trend test components. Therefore, in 2011 the Department proposed a legislative initiative to add the trend test to Pennsylvania's Health RBC statute (40 P.S. §221.1-B). Under the new trend test, an insurer will trigger a "company action level event" if its RBC ratio is between 200% and 300% and its RBC report trend test result (combined ratio) is greater than 105%. Changes to the RBC statute (40 P.S. §221.1-B) will be introduced to amend the trend test for life insurers which is currently triggered when the RBC Ratio is between 200% and 250% to between 200% and 300%. I am also adding Fraternal Benefit Societies to the RBC statute.

2. NAIC Insurance Holding Company System Model Act and Regulation

I have been participating in the efforts of the NAIC Group Solvency Issues (EX) Working Group to update the model holding company law and regulation. The proposed changes include additional annual disclosure requirements to better delineate risks at the holding company level. The NAIC adopted these changes in December 2010. I am anticipating that these amendments will be introduced in early 2012.

3. Credit for Reinsurance Law

At its November 2011 Fall Annual Meeting, the NAIC adopted amendments to its Model Credit for Reinsurance Law allowing for a certified reinsurer that if certain criteria was met as to financial strength and regulatory jurisdiction could reduce collateral requirements. I am anticipating that these amendments will be introduced in early 2012.

Questions concerning this memorandum may be directed to:

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