

*2009 Winter National Meeting
San Francisco, CA*

RISK RETENTION GROUP (E) TASK FORCE

Saturday, December 5, 2009

9:00 – 10:00 a.m.

Hilton San Francisco – Continental 6 – Ballroom Level

ROLL CALL

Scott Richardson, Chair	South Carolina	Glenn Wilson	Minnesota
Jim Ridling	Alabama	Scott J. Kipper	Nevada
Christina Urias	Arizona	Neil N. Jasey	New Jersey
Steve Poizner	California	James J. Wrynn	New York
Karen Weldin-Stewart	Delaware	Kim Holland	Oklahoma
Gennet Purcell	District of Columbia	Joel Ario	Pennsylvania
J.P. Schmidt	Hawaii	Kent Michie	Utah
Sharon P. Clark	Kentucky	Paulette Thabault	Vermont

AGENDA

1. Discuss Annual Financial Reporting Model Regulation (#205) and Corporate Governance Standards Attachment One
2. Discuss Vermont's Letter Regarding the Previously Adopted Part A Standards Attachment Two
3. Discuss Letter Received from the National Risk Retention Association Attachment Three
4. Discuss How New Accreditation Guidance is Reviewed for Applicability to Risk Retention Groups
5. Any Other Matters Brought Before the Task Force

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To: Risk Retention Group (E) Task Force
From: Julie Glaszczak, Senior Accreditation Manager
Date: November 24, 2009
Re: Comparison of Audit Committee Requirements

The following matrix includes information on the specific sections of the *Annual Financial Reporting Model Regulation* (#205) that are currently required for traditional insurers for accreditation purposes. It also includes any guidance included in the Corporate Governance standards and whether there is a conflict between these two documents.

Model #205 Section	Requirement of Model #205	Related Info in Corporate Governance Standards?	Conflict between Model #205 and Corporate Governance Standards?
4D	Every insurer shall designate an Audit Committee, and this can be the full Board of Directors. Section 14J allows insurers to apply for a hardship waiver.	Yes. Section 4 indicates that the risk retention group (RRG) shall have an Audit Committee. Section 4B includes provisions for a hardship waiver.	No.
7J	All auditing and non-audit services shall be preapproved by Audit Committee. Preapproval of non-audit services may be waived in certain circumstances.	Section 3D indicates that the Board of Directors is required to review and approve all amounts paid to <u>material</u> service providers. Section 3Eiii indicates that the Board of Directors will review and approve, at least annually, the continued engagement of material service providers. Note: It is being assumed that the approval will happen prior to commencement of the work and thereby be pre-approved.	1) Model #205 is slightly stronger because it requires pre-approval of all audit services and not just material ones. It does allow waivers on certain non-audit services. If an insurer complies with Model #205, then it would also be complying with the Corp Governance standards. 2) There is a conflict between whether the Board of Directors or the Audit Committee approves payments. 3) The waiver requirements for non-audit services in Model #205 may not be allowed in the Corporate Governance standards if it is a material service provider. <u>Solution:</u> To alleviate the conflicts, the definition of material service provider in the Corporate Governance standards can be revised to specifically exclude auditors. An additional sentence could be added to

			note that specific requirements related to audits are in the Model #205.
14A	The Audit Committee is responsible for the appointment, compensation and oversight of the CPA, who reports directly to the Audit Committee.	Section 3iii indicates that the Board of Directors is required to review and approve, at least annually, the continued engagement of material service providers. Section 4Ai indicates that the Audit Committee must assist the Board's oversight of qualifications, independence and performance of the CPA.	1) The CPA may not be a material service provider. 2) There is a conflict between whether the Board of Directors or the Audit Committee is responsible in certain areas. <u>Solution:</u> To alleviate the conflicts, the definition of material service provider in the Corporate Governance standards can be revised to specifically exclude auditors. An additional sentence could be added to note that specific requirements related to audits are in the Model #205.
14B	All Audit Committee members should also be members of the Board of Directors.	Section 4 indicates that RRGs shall have an Audit Committee composed of at least three independent members of the Board of Directors. Those Board of Directors members that are not independent cannot be Audit Committee members.	No.
14C	In order to be independent, the Audit Committee member may not accept consulting, advisory or other fees from the insurer.	"Independent" is defined in Section 1.	"Independence as discussed in Model #205 is based on compensation and affiliation. "Independence" as defined in the Corporate Governance allows affiliation and is based on compensation and other business or familial relationships.
14D	If individuals cease to be independent outside of their reasonable control, they can remain on the Audit Committee for a period of time.	The Corporate Governance standards are silent on this issue.	No.
14E	This section includes guidance for exercising the ability to designate the Audit Committee of an entity's controlling insurer as the insurer's Audit Committee.	The Corporate Governance standards are silent on this issue.	No.
14F	The Audit Committee must require the auditor to report certain items to the Audit	The Corporate Governance standards are relatively silent on this. Section 4Aiii	No.

	Committee.	notes that the Audit Committee must discuss the financial reports with the CPA, and Section 4A vi indicates that the Audit Committee must review any audit problems with the CPA.	
14G	This section includes guidance for the proportion of Audit Committee members that must be independent. This is based on premium level.	Section 4 indicates that the Audit Committee shall be composed of at least three independent board members. Non-independent board members cannot serve on the Audit Committee.	There is no conflict, except for what is considered “independent.” This is discussed in 14C above.
14H	This section includes instructions for insurers to apply for waiver of Section 14 requirements based on hardship. It does not include specific guidance on when such applications for waivers should be approved or denied.	Section 4B indicates that the regulator may waive independence requirements, but may not waive all of the Audit Committee requirements.	No.

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National Association of Insurance Commissioners

To: Risk Retention Group (E) Task Force
From: Julie Glaszczak, Senior Accreditation Manager
Date: Updated as of May 31, 2008
Re: Part A Accreditation Standards Summary Memo

Discussion of Part A Standards that do NOT Require Substantially Similar Language

Standard	Type of Requirement	Task Force Consensus
13. Receivership	Receivership scheme	Applicable to captive RRGs
14. Guaranty Funds	N/A as captive RRGs do not participate in guaranty funds	Not applicable to captive RRGs
16. Producer Controlled Insurers	Regulatory framework	Applicable to captive RRGs
17. Managing General Agents	Regulatory framework	Applicable to captive RRGs
18. Reinsurance Intermediaries	Regulatory framework	Applicable to captive RRGs

Note: If a state can provide evidence that none of the entities contemplated in standards 16, 17 or 18, is either present or allowed to operate in the state, it will not need to demonstrate compliance with that standard.

Discussion of Part A Standards that DO Require Substantially Similar Language

The following Part A standards do require language substantially similar to certain model laws and regulations. Therefore, the task force has discussed each of the significant elements in detail and the results of the discussions are included below.

1. Examination Authority

Significant Element	Task Force Consensus or Comments
(a) Authority to examine companies whenever deemed necessary.	Applicable to captive RRGs
(b) Complete access to company's books and records.	Applicable to captive RRGs
(c) Access to records of Affiliated companies, agents and/or MGAs.	Applicable to captive RRGs
(d) Examine under oath officers, employees, and agents.	Applicable to captive RRGs
(e) Examine all domestic insurers no less frequently than every five years.	Applicable to captive RRGs

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(f) Require examiners to observe those guidelines and procedures set forth in the NAIC <i>Financial Condition Examiners Handbook</i> .	<p>Generally applicable to captive RRGs. However, the Task Force recognizes that certain elements of the Examiners Handbook are not applicable to captive RRGs. The state should clearly document any variances from the Examiners Handbook. The Examiners Handbook allows for professional judgment in determining which procedures are applicable. The appropriateness of the examination procedures performed would be assessed in conjunction with the Part B standards.</p> <p>A state may need to perform procedures in addition to those in the Examiners Handbook for RRG-specific or GAAP- specific items (e.g., deferred acquisition costs, reserve discounting, etc.). Additional procedures should be developed by the NAIC particularly due to the significant growth of the number of RRGs and for uniformity purposes.</p>
(g) Authority to retain professionals and specialists, the cost of which shall be borne by the insurer.	Applicable to captive RRGs
(h) Authority to use information discovered during any examination in legal action.	Applicable to captive RRGs
(i) Establish guidelines to ensure reports are timely similar to Section 5 of the Model Exam Law.	Applicable to captive RRGs
(j) Authority for the Commissioner to disclose the content of an examination report to an agency or office with a written confidential agreement.	Applicable to captive RRGs

2. Capital and Surplus Requirement

Significant Element	Task Force Consensus or Comments
(a) Require insurers to maintain minimum capital and surplus.	Applicable to captive RRGs.
(b) Authority to require additional capital and surplus based on the type, volume, and nature of business transacted.	Applicable to captive RRGs.
Risk-Based Capital for Insurers Model Act	
(c) Definitions similar to those in Section 1.	<p>Not currently applicable to captive RRGs. The Task Force has identified the following for inclusion in the Task Force's final report:</p> <p>Many RRGs report on an accounting basis other than SAP. GAAP is often utilized and letters of credit may support surplus amounts. Some of the primary differences between SAP and GAAP include capitalization of deferred policy acquisition costs, admission of certain prepaid assets, discounting of loss reserves, valuation of investments and capitalization of deferred taxes.</p> <p>The Task Force agrees that utilization of a basis of accounting that differs significantly from SAP may produce RBC amounts that differ dramatically had SAP been used. As such, the Task Force recognizes that the current RBC formulas may not be the best tool to utilize for RRGs. Although there are differences in opinion on how this should be done, the Task Force generally agrees that there</p>

	should be some sort of consistent formula to assess the capital levels given the assumed level of risk for RRGs. Consideration of such is beyond the charge of this Task Force. The Task Force recommends that the Financial Condition (E) Committee consider whether consider of such should be referred to the Capital Adequacy Task Force.
(d) Provisions to RBC Reports similar to Section 2.	See significant element (c).
(e) Definitions of Company Action Level Event and processes regarding such similar to Section 3.	See significant element (c).
(f) Definitions of Regulatory Action Level Event and processes regarding such similar to Section 4.	See significant element (c).
(g) Definitions of Authorized Control Level Event and processes regarding such similar to Section 5.	See significant element (c).
(h) Definitions of Mandatory Control Level Event and processes regarding such similar to Section 5.	See significant element (c).
(i) Provisions for Hearings similar to those in Section 7.	See significant element (c).
(j) Confidentiality and Prohibition on Announcement provisions similar to those in Section 8.	See significant element (c).
(k) Supplemental provisions similar to Section 9.	See significant element (c).
(l) Provisions for foreign insurers similar to Section 10.	See significant element (c).
(m) Severability provisions similar to Section 12.	See significant element (c).
(n) Notice provisions similar to Section 13.	See significant element (c).

3. NAIC Accounting Practices and Procedures

Significant Element	Task Force Consensus or Comments
(a) Require NAIC Annual Statement Blank.	Applicable to captive RRGs. The Task Force will make a recommendation to the Financial Condition (E) Committee regarding modifications to the annual and quarterly financial statement blanks so that one may be able to readily identify those companies that utilize an accounting basis that differs from SAP.
(b) Prepared in accordance with NAIC Annual Statement Instructions.	Generally applicable to captive RRGs. However, parts of the Annual Statement Instructions may be not applicable if the accounting basis utilized is something other than SAP. The Financial Condition (E) Committee should consider whether revisions to the Annual Statement Instructions should be made to identify those items that are not applicable to RRGs. The Annual Statement Instructions should also include some sort of indication that if “Risk Retention Group” is included in the name of

	<p>an insurer, an accounting basis other than SAP may be used.</p> <p>The Task Force agreed that Management’s Discussion and Analysis should be filed by an RRG in accordance with the Instructions. Further, RRGs should also follow requirements in the Instructions regarding the actuarial opinion (including prescription of minimum standards for liabilities). The Instructions includes information on the annual audited financial report, but this information is identical to that contemplated in the “CPA Audits” standard.</p> <p>States take differing positions on whether RRGs are authorized to write contractual liability business. Some states are “first-dollar” states so that if an RRG writes contractual liability business, it may be responsible for 100% of the claims arising from that contract. Any actuarial opinion should address all business and potential claims applicable to RRGs, including those under contractual liability business.</p> <p>Included in the recommendation noted in element (a) above will be a request to also develop specific instructions for those items in the annual or quarterly statement blanks that may be different depending on whether an insurer files on a GAAP or a SAP basis. In addition, for the instructions specifically regarding annual audited financial reports, the Task Force will inform the Blanks Working Group that there should be a slight modification noting that the audited report of an RRG may be for an insurer that utilized a basis of accounting other than SAP.</p>
(c) Follow NAIC Accounting Practices & Procedures Manual.	<p>Generally applicable to captive RRGs. However, another form of accounting basis may be prescribed or permitted (such as GAAP or modified GAAP) but a reconciliation to SAP must be included in the notes.</p> <p>The Task Force sent a referral to the Statutory Accounting Principles Working Group related to the issue of accounting basis. Although a formal response was not received, discussions held indicate that deviations from SAP (including usage of GAAP or modified GAAP) are within the parameters of a permitted practice.</p>

4. Corrective Action

Significant Element	Task Force Consensus or Comments
(a) Identify standards to determine whether the continued operation of any licensed insurer might be hazardous to the policyholders or the general public.	Applicable to captive RRGs.
(b) Authority for the Commissioner to issue an order requiring the insurer to take action(s) when a company has been determined hazardous to policy holders or the general public.	Applicable to captive RRGs.
(c) Ability for the insurer to request a hearing to review any order issued, privately with Commissioner, unless a public hearing is requested.	Applicable to captive RRGs.

5. Valuation of Investments

Significant Element	Task Force Consensus or Comments
(a) Require all securities owned by insurers be valued in accordance with NAIC's SVO.	Applicable to captive RRGs that utilize SAP. If using GAAP or modified GAAP, the state must have authority to determine valuation of securities, which may include the SVO. Regardless of method of accounting used, reconciliation back to SAP must be included in the notes.
(b) Require that other invested assets be valued in accordance with the NAIC Accounting Practices and Procedures Manual.	Applicable to captive RRGs that utilize SAP. If using GAAP or modified GAAP, the state must have authority to determine valuation of securities, which may include the SVO. Regardless of method of accounting used, reconciliation back to SAP must be included in the notes.

6. Holding Company Systems

Significant Element	Task Force Consensus or Comments
(a) Define control as presumed to exist if any person holds with the power to vote or holds proxies representing 10% or more of the voting securities of any other person, which presumption may be rebutted by showing that control does not exist in fact and define similar to Section 1.	<p>The Task Force agrees that there may be instances in which an RRG is part of a holding company system, as defined in the model. Further, the Task Force generally agrees that the requirements of the Holding Company Systems standard should apply to RRGs. However, it should be noted that there is a provision within the Model that allows for exemptions to the model based on disclaimer of affiliation. This allows the commissioner flexibility in applying the requirements of the model.</p> <p>During its discussion of the Part B accreditation standards, the Task Force will address the issue of communication to other states as it relates to items such as exemptions to the model requirements based on disclaimer of affiliation. It should be discussed whether this communication should just indicate that an exemption was granted or also indicate why an exemption was granted.</p>
(b) Insurer's investments limited to the lesser of 10% of the insurer's assets or 50% of the insurer's surplus as regards policyholders except in instances where a greater investment has been approved by the Commissioner?	See significant element (a).
(c) Filing requirements similar to those specified in Section 3A of the model.	See significant element (a).
(d) Statement filed in accordance with c. above required to include items similar to those specified in Section 3B of the model.	See significant element (a).
(e) Approval and hearing provisions similar to those specified in section 3D of the model.	See significant element (a).
(f) Authority to retain, at the acquiring person's expense, any experts as may be reasonably necessary in reviewing proposed change of control.	See significant element (a).
(g) Jurisdiction and consent to service of process provisions similar to those specified in Section 3G of the model.	See significant element (a).

(h) Require all insurers authorized to do business in the state to register with the department annually, except foreign insurers subject to similar registration requirements in their jurisdiction of domicile.	See significant element (a).
(i) Registration statements required to contain information similar to that required by Sections 4B and C of the model.	See significant element (a).
(j) Transactions within a holding company system subject to the following standards similar to Section 5A(1):	See significant element (a).
- The terms shall be fair and reasonable.	See significant element (a).
- Charges or fees for services performed shall be reasonable.	See significant element (a).
- Expenses incurred and payment received shall be allocated to the insurer and consistently applied.	See significant element (a).
- The books shall accurately disclose the nature and details of the transactions to support the reasonableness of the charges or fees.	See significant element (a).
- The surplus following any distributions shall be reasonable.	See significant element (a).
(k) The following transactions involving a domestic insurer and any person in its holding company system require notification of the department at least 30 days prior to the transaction similar to Section 5A(2):	See significant element (a).
- sales, purchases, exchanges, loans or extensions of credit, guarantees or investments equal to or exceed: a) nonlife – lesser of 3% of admitted assets or 25% of surplus; b) life – 3% of admitted assets; each as of the 31 st of December next preceding.	See significant element (a).
- Loans or extensions of credit provided transactions are equal to or exceed: a) nonlife – lesser of 3% of admitted assets or 25% of surplus; b) life – 3% of admitted assets; each as of the 31 st of December next preceding.	See significant element (a).
- Reinsurance agreements in which the premium or change in liabilities equals or exceeds 5% of the surplus as of the 31 st of December next preceding.	See significant element (a).
- All management agreements, service contracts, and all cost-sharing arrangements.	See significant element (a).
- Any material transactions, which the Commissioner determines may adversely affect the interests of the policyholders.	See significant element (a).
(l) Domestic insurers specifically prohibited from entering into transactions if the purpose of those separate transactions is to avoid a statutory threshold amount and thus avoid the review that would otherwise occur.	See significant element (a).
(m) Department notification required by a domestic insurer at least 30 days prior to paying an extraordinary dividend or making an extraordinary distribution.	See significant element (a).

(n) Extraordinary dividend/distribution defined as cash or other property, whose fair market value together with other dividends made within the preceding 12 months exceeds the lesser of (1) 10% of surplus (2) net gain from operations, or an approved similar alternative by the F Committee.	See significant element (a).
(o) Authority to order any registered insurer to produce such information in the possession of the insurer or its affiliates as are reasonably necessary to ascertain the financial condition or to determine compliance with the holding company act.	See significant element (a).
(p) Provisions for injunctions, prohibitions against voting securities, and sequestration of voting securities similar to Section 9 of the model.	See significant element (a).
(q) Recovery provisions similar to Section 12 of the model.	See significant element (a).
(r) Regulation setting forth rules to carry out the holding company act and for reporting forms similar to those in the NAIC model regulation Sections 10, 11, 13, 14, & 15 for: Form A, B, C, and D.	See significant element (a).
(s) Regulation setting forth rules for disclaimers and terminations similar to Section 18 of the model regulation.	See significant element (a).
(t) Regulation setting forth rules for filing extraordinary dividends and other distributions similar to Section 20 of the model regulation.	See significant element (a).

7. Risk Limitation

Significant Element	Task Force Consensus or Comments
(a) Limit net amount of risk retained for an individual risk to no more than 10% of a property/casualty insurer's capital and surplus.	The specific 10% limitation may not be appropriate for RRGs. However, the state insurance department should have clear authority in statute or regulation to limit the net amount of risk retained for an individual risk.

8. Investment Regulations

Significant Element	Task Force Consensus or Comments
(a) "External" limits for all types of investments.	Applicable to captive RRGs
(b) "Internal" limits for all types of investments.	Applicable to captive RRGs
(c) Authority to require insurers to limit certain investments or discontinue practices if determined that the continuous operation is hazardous.	Applicable to captive RRGs

9. Liabilities and Reserves

Significant Element	Task Force Consensus or Comments
(a) Prescribe minimum standards for establishment of claims liabilities and life, active life, unearned premium, and loss reserves.	Not applicable for those items specific to life/health companies (i.e., life and active life reserves). Other items are applicable to captive RRGs (i.e., unearned premium reserves, claim liabilities and loss reserves) and the Annual Statement Instructions should include detailed information on the minimum provisions for reserves for property/casualty companies.
Standard Valuation Law	Significant elements (b) and (c) are not applicable as the Standard Valuation Law only applies to life/health companies.
(b) Prescribe minimum provisions on actuarial opinion of reserves similar to those in Section 3.	Not applicable.
(c) Prescribe minimum provisions for establishment of reserves similar to those in Section 4.	Not applicable.
Actuarial Opinion Memorandum Regulation	Significant elements (d) through (k) are not applicable as the Actuarial Opinion Memorandum Regulation only applies to life/health companies.
(d) Scope provisions similar to those in Section 3.	Not applicable.
(e) Definitions similar to Section 4.	Not applicable.
(f) General Requirements similar to Section 5.	Not applicable.
(g) Provisions for required opinions similar to Section 6.	Not applicable.
(h) Provisions for statement of actuarial opinion not including an asset adequacy analysis similar to Section 7.	Not applicable.
(i) Provisions for statement of actuarial opinion based on an asset adequacy analysis similar to Section 8.	Not applicable.
(j) Provisions for description of an actuarial memorandum including an asset adequacy analysis similar to Section 9.	Not applicable.
(k) Provisions for additional considerations for analysis similar to Section 10.	Not applicable.

10. Reinsurance Ceded

Significant Element	Task Force Consensus or Comments
Credit for Reinsurance Model Law	
(a) Credit allowed for reinsurance ceded to a licensed insurer.	Applicable to captive RRGs after adding the following sentence: "If the reinsurer is licensed as a risk retention group, then the ceding risk retention group or its members must qualify for membership with the reinsurer."
(b) Credit allowed for reinsurance ceded to an accredited insurer who meets requirements similar to	Applicable to captive RRGs.

those in Section 1.B. of the model law.	
(c) Credit allowed for reinsurance ceded to an insurer domiciled and licensed in a state which employs substantially similar credit for reinsurance standards, maintains at least \$20,000,000 in capital and surplus, and submits to this states authority to examine its books and records.	Applicable to captive RRGs.
(d) Credit allowed for reinsurance ceded to an insurer who maintains a trust fund in a qualified U.S. institution for the payment of valid claims and reports annual financial information to determine sufficiency of the fund.	Applicable to captive RRGs.
(e) In instances where reinsurance is ceded to insurers maintaining a trust fund, trustees of the trust required to annually report the trust balance, asset listing, and date of termination.	Applicable to captive RRGs.
(f) Credit for reinsurance allowed under c. or d. above only permitted where assuming insurer agrees: 1) in the event of a failure to submit to the jurisdiction of any court of competent jurisdiction; 2) to designate Commissioner or an attorney whom may be served by or on behalf of the ceding company.	Applicable to captive RRGs.
(g) Credit allowed for reinsurance ceded to an insurer not meeting the requirements of a., b., c., or d. above in an amount not exceeding the liabilities and only in the amount of acceptable forms of security.	Applicable to RRGs. In addition, a new significant element should be added, which indicates the following: “Although not required for accreditation, a state’s laws and regulations may allow RRGs licensed as captive insurers to take credit for reinsurance without posting collateral in circumstances not contemplated by the Credit for Reinsurance Model Law and Regulations. For such cases, the Accreditation Interlineations include “Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers” and a state’s laws and regulations must comply with the guidelines in order to be considered substantially similar with this standard. If your state’s laws and regulations do allow credit for reinsurance without collateral as discussed in the Accreditation Interlineations, please include in the citation.”
Life and Health Reinsurance Agreements Model Regulation	
(h) Scope similar to Section 3.	Significant elements (h) through (m) are not applicable as the Life and Health Reinsurance Agreements Model Regulation only applies to life/health companies.
(i) No insurer, for reinsurance ceded establishes any asset or reduces liability due to the terms of the agreement, in substance or effect if any of the conditions in Section 4A exist.	Not applicable.
(j) Agreements entered into after the effective date of this regulation which involve business issued prior to the effective date, shall be filed within 30 days from the execution date along with attachments noted in	Not applicable.

Section 4C(1).	
(k) Any increase in surplus net of federal income tax resulting from arrangements described in Section 4C(1) to be reported as described in Section 4C(2).	Not applicable.
(l) Written agreements with provisions similar to Section 5.	Not applicable.
(m) Insurers required to reduce to zero any reserve established prior to the effective date, which would not be recognized under this regulation.	Not applicable.
Credit for Reinsurance Model Regulation	
(n) Credit for reinsurance allowed for reinsurance ceded by domestic reinsurers to assuming insurers that were licensed in the state as of the last date of the ceding insurers' statutory financial statement.	See significant element 10(a) above regarding allowing credit for reinsurance ceded to a licensed insurer as permitted by the Credit for Reinsurance Model Law.
(o) Credit for reinsurance provisions for accredited reinsurer similar to Section 5.	See significant element 10(b) above regarding allowing credit for reinsurance for accredited reinsurers as permitted by the Credit for Reinsurance Model Law.
(p) Credit for reinsurance provisions for reinsurers licensed and domiciled in other states similar to Section 6.	See significant element 10(c) above regarding allowing credit for reinsurance ceded to an insurer domiciled and licensed in a state which employs substantially similar credit for reinsurance standards as permitted by the Credit for Reinsurance Model Law.
(q) Credit for reinsurance provisions for reinsurers maintaining trust funds similar to Section 7.	See significant element 10(d) above regarding allowing credit for reinsurance ceded to an insurer who maintains a trust fund in a qualified U.S. institution as permitted by the Credit for Reinsurance Model Law.
(r) Credit for reinsurance required by law similar to Section 8.	Applicable to captive RRGs to the extent permitted by 15 USC 3902(a).
(s) Reduction from liability for reinsurance ceded to an unauthorized assuming insurer similar to Section 9.	See significant element 10(g) above regarding credit allowed for reinsurance ceded to an insurer not meeting the four main requirements included in the Credit for Reinsurance Model Law.
(t) Provisions for trust agreements similar to Section 10.	Applicable to captive RRGs.
(u) Provisions for letters of credit similar to Section 11.	Applicable to captive RRGs.
(v) Provisions for unencumbered funds similar to Section 12.	Applicable to captive RRGs.
(w) Provisions for reinsurance contracts similar to Section 13.	Section 13A of the Credit for Reinsurance Model Regulation – Applicable to captive RRGs. Section 13B of the Credit for Reinsurance Model Regulation – See significant element 10(g) above regarding credit allowed for reinsurance ceded to an insurer not meeting the four main requirements included in the Credit for Reinsurance Model Law.
(x) The adoption of Form AR-1 – Certificate of Assuming Insurer.	Applicable to captive RRGs when credit for reinsurance is taken as allowed by sections 5, 6, 7, and 9 of the model regulation. For

	situations in which credit for reinsurance is taken in situations not contemplated by the model regulation, significant element (g) above would be applicable. The reinsurance guidelines associated with significant element (g) discuss requirements related to submitting to a court of competent jurisdiction.
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11. CPA Audits

Significant Element	Task Force Consensus or Comments
(a) Requires audited financial statement prepared in conformity with SAP prescribed or permitted to be filed on or before June 1 for the preceding year ending Dec. 31.	Applicable to captive RRGs. However the financial statements may be prepared in conformity with GAAP, or some other modification of GAAP. A reconciliation back to SAP would be required in the footnotes. The Task Force sent a referral to the Statutory Accounting Principles Working Group related to the issue of accounting basis. Although a formal response was not received, discussions held indicate that deviations from SAP (including usage of GAAP or modified GAAP) are within the parameters of a permitted practice.
(b) Contents of annual audited financial report similar to Section 5 of the model rule.	Applicable to captive RRGs. However, the exact titles, footnotes, etc. of the various reports may be somewhat modified if GAAP accounting is used.
(c) Partner rotation requirements similar to Section 7C of the model rule.	Applicable to captive RRGs
(d) Allow audited consolidated or combined financial statements in regards to pooling.	Applicable to captive RRGs
(e) Independent CPA required to notify insurer's board of directors and Commissioner within 5 business days when financial condition is materially misstated or capital/surplus requirements not met.	Applicable to captive RRGs
(f) Require report be filed with the Commissioner in the event "reportable conditions" were noted during the audit.	Applicable to captive RRGs
(g) Require accountant's letter of qualifications similar to Section 12 of the model rule.	Applicable to captive RRGs
(h) Insurer to require CPA to make available for review and retain all workpapers and communications prepared during audit.	Applicable to captive RRGs

12. Actuarial Opinion

Significant Element	Task Force Consensus or Comments
Require opinion by qualified actuary or specialist.	Applicable to captive RRGs. Current standards for accreditation simply state that an actuarial opinion should be required but they do not discuss the form or content of the opinion.

15. Filings with NAIC

Significant Element	Task Force Consensus or Comments
Require domestic companies to file annual and quarterly statements with the NAIC.	Applicable to captive RRGs
Require such companies to file in an electronic format acceptable to the NAIC.	Applicable to captive RRGs

To: Risk Retention Group (E) Task Force Members
From: Julie Glaszczak, Senior Accreditation Manager
Date: November 24, 2009
Re: Recent Changes to Part A Accreditation Standards

The purpose of this memo is to discuss the Part A: Laws and Regulation Standards that have changed since the Risk Retention Group (E) Task Force first began addressing the Part A Standards in 2003. The following are the Part A standards with recent changes:

1. Capital and Surplus - DONE

In June 2009, the Financial Regulation Standards and Accreditation (F) Committee voted that the 2006 revisions to the *Risk Based Capital for Insurers Model Act* (#312) should be required for accreditation, effective Jan. 1, 2012. These revisions incorporate a new trend test that may trigger a company action level for property/casualty insurers. As the Task Force has previously voted that Model #312 should not apply to risk retention groups (RRGs), the Task Force agreed that the 2006 revisions should also not apply.

2. Liabilities and Reserves - DONE

Effective Jan. 1, 2009, two new significant elements were added to this standard. The new elements are from the 2001 revisions to the *Actuarial Opinion and Memorandum Regulation* (#822) and require assets adequacy testing for all applicable companies and the filing of a regulatory asset adequacy summary by March 15 of each year. Since the Model Regulation only applies to life/health companies, the Task Force agreed that the revisions are not applicable to RRGs.

3. Liabilities and Reserves - DONE

The *Property and Casualty Actuarial Opinion Model Law* (#745) will become an accreditation standard, effective Jan. 1, 2010. Sections 2A, 2B, 3A and 3B(1) of Model #745 are considered significant elements and will be required for accreditation. Below is a matrix that includes the new significant elements.

4. CPA Audits - DONE

Effective Jan. 1, 2008, a new significant element was added to this standard. The new significant element is from the 2001 revisions to the *Annual Financial Reporting Model Regulation* (#205) and indicates that a qualified independent certified public account may not enter into indemnification agreements in regard to the audit of an insurer. The Task Force agreed that this significant element should be required for RRGs. Below is a matrix that includes the new significant element.

5. CPA Audits

In June 2009, the Committee voted that the 2006 revisions to Model #205 should be required for accreditation, effective Jan. 1, 2010. The revisions made to the model are numerous and are related to auditor independence, corporate governance and internal control over financial reporting. Below is a matrix that includes the new significant elements.

EXECUTIVE OFFICE	444 N. Capitol Street, NW, Suite 701	Washington, DC 20001-1509	p 202 471 3990	f 816 460 7493
CENTRAL OFFICE	2301 McGee Street, Suite 800	Kansas City, MO 64108-2662	p 816 842 3600	f 816 783 8175
SECURITIES VALUATION OFFICE	48 Wall Street, 6th Floor	New York, NY 10005-2906	p 212 398 9000	f 212 382 4207

Property/Casualty Actuarial Opinion Model Law (NEW) – DONE

Significant Element	Task Force Consensus or Comments
(1) Requires annual submission of a “Statement of Actuarial Opinion” similar to Section 2A of the model?	Applicable to captive RRGs.
(2) Requires annual submission of an “Actuarial Opinion Summary” similar to Section 2B of the model?	Applicable to captive RRGs.
(3) Requires that the Statement of Actuarial Opinion is provided with the Annual Statement and is treated as a public document similar to Section 3A of the model?	Applicable to captive RRGs.
(4) Includes requirements that various documents related to the Actuarial Report or Actuarial Opinion Summary are confidential by law and privileged similar to Section 3B(1) of the model?	Applicable to captive RRGs.

CPA Audits – 2001 Revisions to the Annual Financial Reporting Model Regulation – DONE

Significant Element	Task Force Consensus or Comments
Prohibits CPA from entering into an agreement of indemnity or release from liability similar to Section 7A of the model rule?	Applicable to captive RRGs.

CPA Audits – 2006 Revisions to the Annual Financial Reporting Model Regulation

Significant Element	Task Force Consensus or Comments
(1) Requires that every insurer required to file an annual audited financial report under the model shall designate a group of individuals as constituting an audit committee similar to that discussed in Section 4D?	The Task Force needs to discuss this element further and consider any related guidance in the Corporate Governance standards.
(2) Prohibits a certified public accountant that performs an audit on an insurer from also providing certain non-audit services to that same insurer as discussed in Section 7G?	Applicable to captive RRGs.
(3) Requires audit committee pre-approval of all auditing services and non-audit services provided by the certified public accountant similar to that discussed in Section 7J?	The Task Force needs to discuss this element further and consider any related guidance in the Corporate Governance standards.
(4) Prohibits certain certified public accountant employees who performed the audit of an insurer from accepting certain employment positions with the insurer for a period of one year as discussed in Section 7L?	Applicable to captive RRGs, pending approval of revised wording of this significant element as follows: Commissioner shall not recognize a CPA as qualified for a particular insurer if an employee in certain positions with the insurer was previously employed by the CPA and

	participated in the audit of the insurer for a certain period of time as discussed in Section 7L.
(5) Requires communication of internal control-related matters noted in an audit similar to Section 11?	Applicable to captive RRGs.
(6) Includes requirements for audit committees similar to that discussed in Section 14?	The Task Force needs to discuss this element further and consider any related guidance in the Corporate Governance standards.
(7) Includes requirements for conduct of the insurer in connection with the preparation of certain reports and documents similar to Section 15?	Applicable to captive RRGs.
(8) Includes requirements related to management's report of internal control over financial reporting similar to Section 16?	Applicable to captive RRGs, however the following language should be added to the significant element: If a state does not have any captive RRGs with premium over \$500 million, it is not required to have this significant element in statute or regulation.

Note: Any significant additions specific to RRGs have been highlighted in yellow.

SELF-EVALUATION GUIDE/INTERIM ANNUAL REVIEW

FOR USE WITH RISK RETENTION GROUPS

**FINANCIAL REGULATION STANDARDS
AND ACCREDITATION PROGRAM**

Check One:

Self-Evaluation Guide

Interim Annual Review

Jurisdiction _____

Prepared by _____ Title _____ Date _____

Commissioner's Approval _____ Date _____

A. LAWS & REGULATIONS

1. Examination Authority

The department should have authority to examine risk retention groups organized as captive insurers (RRGs) whenever it is deemed necessary. Such authority should include complete access to the RRG's books and records and, if necessary, the records of any affiliated company, agent, and/or managing general agent. Such authority should extend not only to inspect books and records but also to examine officers, employees, and agents of the RRG under oath when deemed necessary with respect to transactions directly or indirectly related to the RRG under examination. The NAIC Model Law on Examinations or substantially similar provisions shall be part of state law.

Reference

a. Authority to examine RRGs whenever deemed necessary?

b. Complete access to RRG's books and records?

c. Access to records of:

• Affiliated companies?

• Agents and/or MGAs?

d. Examine under oath:

• Officers?

• Employees?

• Agents?

e. Examine all domestic RRGs no less frequently than every five years?

f. Require examiners to observe those guidelines and procedures set forth in the NAIC *Financial Condition Examiners Handbook* (as applicable to RRGs) supplemented with such other guidelines or procedures as deemed appropriate?

g. Authority to retain attorneys, appraisers, independent actuaries, independent CPAs or other professionals and specialists, the cost of which shall be borne by the RRG?

Reference

h. Authority to use and, if appropriate, make public any final or preliminary examination report, any examination workpapers or other documents, or any other information discovered or developed during the course of any examination in the furtherance of any legal or regulatory action which the Commissioner may deem appropriate?

i. Establish guidelines for the timing of report filing and adoption to ensure reports are timely similar to Section 5 of the Model Exam Law?

j. Authority for the Commissioner to disclose the content of an examination report, preliminary examination report or results, or any matter relating thereto, to the insurance department of any state or country, or to law enforcement officials of any state or country or agency of the federal government at any time, so long as such agency or office receiving the information agrees in writing to hold it confidential?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Examination Authority requirements since last year’s review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

2. Capital and Surplus Requirement

The department should have the ability to require that RRGs have and maintain a minimum level of capital and surplus to transact business. The department should have the authority to require additional capital and surplus based upon the type, volume, and nature of insurance business transacted.

Reference

a. Require RRGs to maintain minimum capital and surplus?

b. Authority to require additional capital and surplus based on the type, volume, and nature of business transacted?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Capital and Surplus requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

3. NAIC Accounting Practices and Procedures

The department should require that RRGs reporting to the department file the appropriate NAIC Annual Statement Blank which should be prepared in accordance with the NAIC's Instructions Handbook, as applicable. The RRGs should follow those accounting procedures and practices prescribed by the NAIC *Accounting Practices and Procedures Manual*¹ or another basis of accounting as permitted or prescribed by state law or regulation.

Reference

a. Require NAIC Annual Statement Blank? _____

b. Prepared in accordance with NAIC Annual Statement Instructions? (Note: If an accounting basis other than SAP is used, certain elements of the Annual Statement Instructions may not be applicable.) _____

c. Follow practices & procedures prescribed by NAIC *Accounting Practices & Procedures Manual* or another basis of accounting as permitted or prescribed by state law or regulation? If an accounting basis other than SAP is used, the state must require a reconciliation to SAP in Note 1. _____

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your requirements for the NAIC Accounting Practices & Procedures since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made. _____

¹ The Preamble to the NAIC *Accounting Practices & Procedures Manual* (the Manual) states that the Manual is not intended to preempt state legislative and regulatory authority [Preamble, para. 19 and 28]. FRSAC recognizes that the purpose of the codification of statutory accounting principles is to produce a comprehensive guide for use by insurance departments, insurers, and auditors [Preamble, para. 12]. Accordingly, FRSAC has determined that accreditation requirements regarding the use of the Manual shall not limit a state's ability, or to require a state, to prescribe or permit any particular accounting treatment. Thus, with regard to the Standard A.3, FRSAC anticipates that each state shall require all insurance companies doing business in that state to file an annual statement blank which should be prepared in accordance with the Annual Statement Instructions; however, FRSAC acknowledges that each state retains the authority to make changes in those statements [Preamble, para. 54]. An accredited state may require or permit adherence to accounting policies, practices or procedures different from those set forth in the Manual, provided that the appropriate disclosures are made, as described and anticipated by SSAP No. 1.

4. Corrective Action

State law should contain the NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in a Hazardous Financial Condition or a substantially similar provision which authorizes the department to order a RRG to take necessary corrective action or cease and desist certain practices which, if not corrected, could place the RRG in a hazardous financial condition.

Reference

- a. Identify specific standards which may be considered by the Commissioner to determine whether the continued operation of any licensed insurer might be hazardous to the policyholders or the general public (similar to Section 3 of the NAIC model) or at a minimum demonstrate with examples that the department has developed standards that have been used to determine whether or not a RRG is in hazardous financial condition?

- b. Authority for the Commissioner, upon his determination that the continued operation of a licensed RRG may be hazardous to policyholders or the general public, to issue an order requiring the RRG to take one or more specific actions (similar to those specified in Section 4B of the NAIC model) or at a minimum demonstrate with examples that the department has the authority to require RRGs it has determined to be in hazardous financial condition to take corrective action?

- c. Ability for the RRG to request a hearing to review any order issued, which hearing will be held privately by the Commissioner, unless the RRG requests a public hearing?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Corrective Action Authority since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

5. Valuation of Investments

The department should require that securities owned by RRGs be valued in accordance with those standards promulgated by the NAIC's Securities Valuation Office (SVO) or, if a basis of accounting other than SAP is used, the state must have authority to determine the valuation of securities. For RRGs that use SAP, other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (E) Committee. For RRGs that use another basis of accounting, the state must have authority to determine valuation of securities.

Reference

- a. For RRGs that use SAP: Require that all securities owned by RRGs be valued in accordance with the standards promulgated by the NAIC's SVO?

For RRGs that use an accounting basis other than SAP: Have authority to determine valuation of securities, which may include the SVO? In addition, insurers required to provide a reconciliation to SAP in Note 1?

- b. For RRGs that use SAP: Require that other invested assets be valued in accordance with the NAIC *Accounting Practices and Procedures Manual*?

For RRGs that use an accounting basis other than SAP: Have authority to determine valuation of securities, which may include the SVO? In additions, insurers required to provide a reconciliation to SAP in Note 1?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Valuation of Investments requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

6. Holding Company Systems

State law should contain the NAIC Model Holding Company Systems Act or an act substantially similar and the department should have adopted the NAIC's model regulation relating to this law.

Reference

- a. Define control as presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing ten percent or more of the voting securities of any other person, which presumption may be rebutted by a showing that control does not exist in fact and define affiliate similar to Section 1?
- b. RRG's investments in common stock, preferred stock, debt obligations, and other securities of subsidiaries, excluding investments in insurance subsidiaries, limited to the lesser of 10% of the RRG's assets or 50% of the RRG's surplus as regards policyholders except in instances where a greater investment has been approved by the Commissioner?
- c. Filing requirements similar to those specified in Section 3A of the model?
- d. Statement filed in accordance with c. above required to include items similar to those specified in Section 3B of the model?
- e. Approval and hearing provisions similar to those specified in section 3D of the model?
- f. Authority to retain, at the acquiring person's expense, any experts as may be reasonably necessary in reviewing proposed change of control?
- g. Jurisdiction and consent to service of process provisions similar to those specified in Section 3G of the model?

Reference

h. Require all RRGs authorized to do business in the state which are members of an insurance holding company system to register with the department annually, except foreign RRGs subject to similar registration requirements in their jurisdiction of domicile?

i. Registration statements required to contain information similar to that required by Sections 4B and C of the model? (Note: Section 4K allows an insurer to file a disclaimer of affiliation, which if not disallowed by the commissioner, would relieve the RRG from the filing requirements in Section 4.)

j. Transactions within a holding company system subject to the following standards similar to Section 5A(1):

- The terms shall be fair and reasonable?

- Charges or fees for services performed shall be reasonable?

- Expenses incurred and payment received shall be allocated to the RRG in conformity with customary insurance accounting practices consistently applied?

- The books, accounts, and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties?

- The RRG's surplus as regards policyholders following any dividends or distributions to shareholder affiliates shall be reasonable in relation to the RRG's outstanding liabilities and adequate to its financial needs?

Reference

k. The following transactions involving a domestic RRG and any person in its holding company system require notification of the department at least thirty days prior to the transaction similar to Section 5A(2):

- Sales, purchases, exchanges, loans, or extensions of credit, guarantees, or investments provided such transactions are equal to or exceed the lesser of three percent of the RRG's admitted assets or twenty-five percent of surplus as regards policyholders each as of the 31st day of December next preceding?
- Loans or extensions of credit to any person who is not an affiliate, where the insurer makes such loans or extensions of credit with the agreement or understanding that the proceeds of such transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investment in, any affiliate of the RRG making such loans or extensions of credit provided such transactions are equal to or exceed the lesser of three percent of the insurer's admitted assets or twenty-five percent of surplus as regards policyholders each as of the 31st day of December next preceding?
- Reinsurance agreements or modifications thereto in which the reinsurance premium or a change in the RRG's liabilities equals or exceeds five percent of the RRG's surplus as regards policyholders, as of the 31st day of December next

Reference

preceding, including those agreements which may require as consideration the transfer of assets from an RRG to a non-affiliate, if an agreement or understanding exists between the RRG and nonaffiliate that any portion of such assets will be transferred to one or more affiliates of the RRG?

- All management agreements, service contracts, and all cost-sharing arrangements?

- Any material transactions, specified by regulation, which the Commissioner determines may adversely affect the interests of the RRG’s policyholders?

- l. Domestic RRGs specifically prohibited from entering into transactions which are a part of a plan or series of like transactions with persons within the holding company system if the purpose of those separate transactions is to avoid a statutory threshold amount and thus avoid the review that would otherwise occur?

- m. Department notification required by a domestic RRG at least 30 days prior to paying an extraordinary dividend or making an extraordinary distribution?

Reference

n. Extraordinary dividend or distribution defined as any dividend or distribution of cash or other property, whose fair market value together with that of other dividends or distributions made within the preceding twelve months exceeds the lesser of (1) ten percent of such RRG’s surplus as regards policyholders as of the 31st day of December next preceding, or (2) the net income, not including realized capital gains, for the 12-month period ending the 31st day of December next preceding, but shall not include pro rata distributions of any class of the RRG’s own securities or an approved substantially similar alternative by the Financial Regulation Standards and Accreditation (F) Committee?

o. Authority to order any registered RRG to produce such records, books, or other information in the possession of the RRG or its affiliates as are reasonably necessary to ascertain the financial condition of the RRG or to determine compliance with the holding company act?

p. Provisions for injunctions, prohibitions against voting securities, and sequestration of voting securities similar to Section 9 of the model?

q. Recovery provisions similar to Section 12 of the model?

Reference

r. Regulation setting forth rules and procedural requirements necessary to carry out the provisions of the holding company act and general requirements for reporting forms similar to those in the NAIC model regulation Sections 10, 11, 13, 14 and 15 for: Form A (Statement Regarding the Acquisition of Control by or Merger With a Domestic Insurer); Form B (Annual Registration Statement); Form C (Summary of Registration Statement); and Form D (Prior Notice of a Transaction)?

s. Regulation setting forth rules for disclaimers and terminations similar to Section 18 of the model regulation?

t. Regulation setting forth rules for filing extraordinary dividends and other distributions similar to Section 20 of the model regulation?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Holding Company Systems Authority since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

7. Risk Limitation

State law should provide the state insurance department with clear authority in statute or regulation to limit the net amount of risk retained for an individual risk.

State insurance department has clear authority in statute or regulation to limit the net amount of risk retained for an individual risk?

Reference

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Risk Limitation requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

8. Investment Regulations

State statute should require a diversified investment portfolio for RRGs both as to type and issue and include a requirement for liquidity. (This standard is assumed by the review team to require that statutes, together with related regulations and administrative practices, provide adequate basis for the Department to prevent, or correct undue concentration of investment by type and issue and unreasonable mismatching of maturities of assets and liabilities. The standard is not interpreted to require an investment statute that automatically leads to a fully diversified portfolio of investments.)

Reference

- a. "External" limits (limiting the aggregate investment that may be made in a category of investments) for all types of investments?
- b. "Internal" limits (limiting the amount that may be invested in any one business, issuer or risk) for all types of investments?
- c. Authority to require RRGs to limit or withdraw from certain investments or discontinue certain investment practices if the Commissioner determines that the continued operation of the RRG might be hazardous to the policy-holders or the general public (corrective action)?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Investment Regulation requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

9. Liabilities and Reserves

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an RRG; including unearned premium reserves and liabilities for claims and losses unpaid and incurred but not reported claims.

Reference

a. Prescribe minimum standards for establishment of:

- Unearned premium reserves?
- Claims liabilities?
- Loss reserves?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Liability and Reserves requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

10. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation or substantially similar laws.

Reference

Credit for Reinsurance Model Law

- a. Credit allowed for reinsurance ceded to a licensed insurer? If the reinsurer is licensed as a RRG, then the ceding RRG or its members must qualify for membership with the reinsurer.
- b. Credit allowed for reinsurance ceded to an accredited insurer who meets requirements similar to those in Section 1.B. of the model law?
- c. Credit allowed for reinsurance ceded to an insurer domiciled and licensed in a state which employs substantially similar standards regarding credit for reinsurance and who maintains capital and surplus of at least \$20,000,000 and submits to this states authority to examine its books and records?
- d. Credit allowed for reinsurance ceded to an insurer who maintains a trust fund, established in a form approved by the Commissioner, in a qualified U.S. financial institution for the payment of the valid claims of its U.S. policyholders and ceding insurers, their assigns and successors in interest and who reports financial information annually to the Commissioner to determine the sufficiency of the trust fund?
- e. In instances where reinsurance is ceded to insurers maintaining a trust fund, trustees of the trust required to report to the Department annually, on or before February 28, the balance of the trust and a listing of the trust's assets as of the end of the year and a certification of the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the next following December 31?

Reference

f. Credit for reinsurance allowed under c. or d. above only permitted where assuming insurer agrees in the reinsurance agreements: 1) that in the event of a failure of the assuming insurer to perform its obligations, the assuming insurer shall submit to the jurisdiction of any court of competent jurisdiction in any state of the U.S.; and 2) to designate the Commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process instituted by or on behalf of the ceding company?

g. Although not required for accreditation, a state's laws and regulations may allow RRGs to take credit for reinsurance without posting collateral in circumstances not contemplated by the Credit for Reinsurance Model Law and Regulation. For such cases, the Accreditation Interlineations include "Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers" and a state's laws and regulations must comply with the guidelines in order to be considered substantially similar with this standard. If your state's laws and regulations do allow credit for reinsurance without collateral as discussed in the Accreditation Interlineations, please include the citation

h. Credit allowed for reinsurance ceded to an insurer not meeting the requirements of a., b., c., d., or g. above in an amount not exceeding the liabilities carried by the ceding insurer and only in the amount of funds held by or on behalf of the ceding insurer in the form of cash, securities listed by the Securities Valuation Office of the NAIC and qualifying as admitted assets, clean, irrevocable, unconditional letters of credit, and other forms of security acceptable to the Commissioner?

Credit for Reinsurance Model Regulation

- i. Credit for reinsurance allowed for reinsurance ceded by domestic reinsurers to assuming insurers that were licensed in the state as of the last date of the ceding insurers' statutory financial statement? If the reinsurer is licensed as a RRG, then the ceding RRG or its members must qualify for membership with the reinsurer.
- j. Credit for reinsurance provisions for accredited reinsurer similar to Section 5?
- k. Credit for reinsurance provisions for reinsurers licensed and domiciled in other states similar to Section 6?
- l. Credit for reinsurance provisions for reinsurers maintaining trust funds similar to Section 7?
- m. Credit for reinsurance required by law similar to Section 8, to the extent permitted by 15 USC 3902(a)?
- n. Reduction from liability for reinsurance ceded to an unauthorized assuming insurer similar to Section 9? (Note: See significant element g. above regarding allowance of credit for reinsurance in certain situations not contemplated by the Model Law.)
- o. Provisions for trust agreements similar to Section 10?
- p. Provisions for letters of credit similar to Section 11?

Reference

q. Provisions for unencumbered funds similar to Section 12?

r. Provisions for reinsurance contracts similar to Section 13A? State should also have provisions similar to Section 13B? Note: For those reinsurance contracts for which credit is allowed under significant element g. above, the reinsurance contract should contain language similar to Section II of the "Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers."

s. The adoption of Form AR-1—Certificate of Assuming Insurer. Note: For situations in which credit for reinsurance is taken under significant element g. above, the reinsurance contract should contain language similar to Section II of the "Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers."

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Ceded Reinsurance requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

11. CPA Audits

State statute or regulation should contain a requirement for annual audits of domestic RRGs by independent certified public accountants, based on the NAIC's Annual Financial Reporting Model Regulation.

Reference

- a. For RRGs that use SAP: Require audited financial statements prepared in conformity with statutory accounting practices prescribed or permitted by the domiciliary state to be filed with the Commissioner on or before June 1 for the year ending December 31 immediately preceding?

For RRGs that use a basis of accounting other than SAP: Require audited financial statements prepared in conformity with accounting principles required by state law, including a reconciliation to SAP in Note 1, on or before June 1 for the year ending December 31 immediately preceding?

- b. Contents of annual audited financial report similar to Section 5 of the model rule?
- c. Partner rotation requirements similar to Section 7D of the model rule?
- d. Allow audited consolidated or combined financial statements only in the instance of a pooling or one hundred percent reinsurance agreement where such insurer cedes all of its direct and assumed business to the pool?

Reference

- e. Independent CPA required to notify RRG's board of directors, in writing, within 5 business days, any determination that the RRG has materially misstated its financial condition as reported to the Commissioner or that the RRG does not meet minimum capital and surplus requirements and also required to notify Commissioner of the same within 5 business days after failing to receive evidence of the report being sent to the Commissioner by the RRG within 5 business days after receipt from the CPA?
- f. Require report of significant deficiencies in internal control be filed with the Commissioner in the event "reportable conditions" were noted by the independent CPA during the audit?
- g. Require accountant's letter of qualifications similar to Section 12 of the model rule?
- h. RRG to require CPA to make available for review by Department examiners all workpapers prepared in the conduct of his audit and any communications related to the audit between the CPA and the RRG, at the Department or at any other reasonable place designated by the Commissioner and require CPA to retain the audit workpapers and communications until the Department has filed an examination report covering the period of the audit but no longer than 7 years from the date of the audit report?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your CPA Audit requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

12. Actuarial Opinion

State statute or regulation should contain a requirement for an opinion on loss and loss adjustment expense reserves by a qualified actuary or specialist annually for all domestic RRGs.

Reference

Require opinion by qualified actuary or specialist?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Actuarial Opinion requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

13. Receivership

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of RRGs found to be insolvent similar to the NAIC’s Insurer Receivership Model Act. (Because of the wording of this standard, the review team requires a receivership “scheme” for the administration, by the Commissioner, of RRGs found to be insolvent which is generally similar to the receivership “scheme” discussed in the NAIC Model. The review team assumes that strict adherence to the NAIC Model Act is not required.)

Reference

Receivership “scheme” similar to that set forth in the NAIC Insurer Receivership Model Act?

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Receivership scheme since last year’s review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

14. Filings with NAIC

State statute, regulation or practice should mandate filing of annual and quarterly statements with the NAIC in a format acceptable to the NAIC except that states may exempt from this requirement those RRGs that operate only in their state of domicile.

Reference

a. Require domestic RRGs to file annual and quarterly statements with the NAIC.

b. Require such RRGs to file annual and quarterly statements in an electronic format acceptable to the NAIC.

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your NAIC filing requirements since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

15. Producer Controlled Insurers

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Model Law for Business Transacted with Producer Controlled Property/Casualty Insurer Act or similar provisions.

(Note: If state can provide evidence that the entities contemplated by the NAIC Model Act are neither present nor allowed to operate in the state, it will not need to demonstrate compliance with this standard.)

Reference

Regulatory framework such as contained in the NAIC Model Law for Business Transacted with Producer Controlled Property/Casualty Insurer Act.

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Producer Controlled Property/Casualty Insurer Authority since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

16. Managing General Agents Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Managing General Agents Act or similar provisions.

(Note: If state can provide evidence that the entities contemplated by the NAIC Model Act are neither present nor allowed to operate in the state, it will not need to demonstrate compliance with this standard.)

Reference

Regulatory framework such as contained in the NAIC Managing General Agents Model Act.

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Managing General Agents Authority since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

17. Reinsurance Intermediaries Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Reinsurance Intermediary Model Act or similar provisions.

(Note: If the state can provide evidence that the entities contemplated by the NAIC Model Act are neither present nor allowed to operate in the state, it will not need to demonstrate compliance with this standard.)

Reference

Regulatory framework such as contained in the NAIC Reinsurance Intermediaries Model Act.

Complete the following if this is an Interim Annual Review:

YES

NO

Have there been any changes to your Reinsurance Intermediaries Authority since last year's review? If no, please do **NOT** attach copies of your statutes or regulations. If yes, please attach a copy of your statutes or regulations and ensure that they are clearly marked for the changes that have been made.

The tracked changes below are revisions proposed by NAIC Staff to avoid any conflict between these governance standards and those included in the Annual Financial Reporting Model Regulation (#205). This information has been prepared for use during the Risk Retention Group (E) Task Force's meeting on Dec. 5, 2009.

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Governance Standards For Risk Retention Groups

- 1) Independent Directors The board of directors of the risk retention group shall have a majority of independent directors. If the risk retention group is a reciprocal, then the attorney-in-fact would be required to adhere to the same standards regarding independence of operation and governance as imposed on the risk retention group's board of directors/subscribers advisory committee under these standards; and, to the extent permissible under state law, service providers of a reciprocal risk retention group should contract with the risk retention group and not the attorney-in-fact.
 - A) No director qualifies as "independent" unless the board of directors affirmatively determines that the director has no "material relationship" with the risk retention group. Each risk retention group shall disclose these determinations to its domestic regulator, at least annually. For this purpose, any person that is a direct or indirect owner of or subscriber in the risk retention group (or is an officer, director and/or employee of such an owner and insured, unless some other position of such officer, director and/or employee constitutes a "material relationship"), as contemplated by Section 3901(a)(4)(E)(ii) of the Liability Risk Retention Act, is considered to be "independent."
 - B) "Material relationship" of a person with the risk retention group includes, but is not limited to:
 - i) The receipt in any one 12-month period of compensation or payment of any other item of value by such person, a member of such person's immediate family or any business with which such person is affiliated from the risk retention group or a consultant or service provider to the risk retention group is greater than or equal to five percent (5%) of the risk retention group's gross written premium for such 12-month period or two percent (2%) of its surplus, whichever is greater, as measured at the end of any fiscal quarter falling in such a 12-month period. Such person or immediate family member of such person is not independent until one year after his/her compensation from the risk retention group falls below the threshold.
 - ii) A relationship with an auditor as follows: a director or an immediate family member of a director who is affiliated with or employed in a professional capacity by a present or former internal or external auditor of the risk retention group is not independent until one year after the end of the affiliation, employment or auditing relationship.
 - iii) A relationship with a related entity as follows: a director or immediate family member of a director who is employed as an executive officer of another company where any of the risk retention group's present executives serve on that risk retention group's board of directors is not independent until one year after the end of such service or the employment relationship.
- 2) Service Provider Contracts The term of any material service provider contract with the risk retention group shall not exceed five (5) years. Any such contract, or its renewal, shall require the approval of the majority of the risk retention group's independent directors. The risk retention group's board of directors or its owners/insureds shall have the right to terminate any service provider-~~audit~~ or actuarial contracts at any time for cause after providing adequate notice as defined in the contract. The service provider contract is deemed material if the amount to be paid for such contract is greater than or equal to five percent (5%) of the risk retention group's annual gross written premium or two percent (2%) of its surplus, whichever is greater.
 - A) For purposes of this standard, "service providers" shall include captive managers, ~~auditors~~, accountants, actuaries, investment advisors, lawyers, managing general underwriters or other party responsible for underwriting, determination of rates, collection of premium, adjusting and settling claims and/or the preparation of financial statements. Any reference to 'lawyers' in the prior sentences does not include defense counsel retained by the risk retention group to defend claims, unless the amount of fees paid to such lawyers are 'material' as referenced in Section (1)(B) above. This definition does not include the risk retention group's independent auditors as corporate governance guidance for those are included in the Annual Financial Reporting Model Regulation.

- B) No service provider contract meeting the definition of "material relationship" contained in Section (1)(B) shall be entered into unless the risk retention group has notified the Commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto and the Commissioner has not disapproved it within such period.
- 3) Written Charter The risk retention group's board of directors shall have a written policy in the Bylaws that requires the board to:
- A) assure that all owner/insureds of the risk retention group receive evidence of ownership interest;
 - B) develop a set of governance standards applicable to the risk retention group;
 - C) oversee the evaluation of the risk retention group's management;
 - D) review and approve the amount to be paid for all material service providers; and
 - E) review and approve, at least annually:
 - i) the risk retention group's goals and objectives relevant to the compensation of officers and service providers;
 - ii) the officers' and service providers' performance in light of those goals and objectives; and,
 - iii) the continued engagement of the officers and material service providers.
- 4) Audit Committee The risk retention group shall have an audit committee composed of at least three independent board members as defined in Section (1). A non-independent board member may participate in the activities of the audit committee, if invited by the members, but cannot be a member of such committee.
- A) The audit committee shall have a written charter that defines the committee's purpose, which, at a minimum, must be to:
- i) assist board oversight of (1) the integrity of the financial statements, (2) the compliance with legal and regulatory requirements, (3) the qualifications, independence and performance of the independent auditor and actuary, and (4) the performance of the captive manager, managing general underwriter or other party or parties responsible for underwriting, determination of rates, collection of premium, adjusting or settling claims or the preparation of financial statements;
 - ii) discuss the annual audited financial statements and quarterly financial statements with management;
 - iii) discuss the annual audited financial statements with its independent auditor and, if advisable, discuss its quarterly financial statements with its independent auditor;
 - iv) discuss policies with respect to risk assessment and risk management;
 - v) meet separately and periodically, either directly or through a designated representative of the committee, with management and independent auditors;
 - vi) review with the independent auditor any audit problems or difficulties and management's response;
 - vii) set clear hiring policies of the risk retention group as to the hiring of employees or former employees of the independent auditor;
 - viii) require the external auditor to rotate the lead (or coordinating) audit partner having primary responsibility for the risk retention group's audit as well as the audit partner responsible for reviewing that audit so that neither individual performs audit services for more than five (5) consecutive fiscal years; and
 - ix) report regularly to the board of directors.

- B) The domestic regulator may waive the requirement to establish an audit committee composed of independent board members if the risk retention group is able to demonstrate to the domestic regulator that it is impracticable to do so and the risk retention group's board of directors itself is otherwise able to accomplish the purposes of an audit committee, as described in Section (4)(a).
- 5) Governance Standards The risk retention group shall adopt and disclose governance standards, where "disclose" means making such information available through electronic (e.g., posting such information on the risk retention group's website) or other means, and providing such information to members/insureds upon request, which shall include:
- A) a process by which the directors are elected by the owner/insureds;
 - B) director qualification standards;
 - C) director responsibilities;
 - D) director access to management and, as necessary and appropriate, independent advisors;
 - E) director compensation;
 - F) director orientation and continuing education;
 - G) management succession; and
 - H) annual performance evaluation of the board.
- 6) Business Conduct and Ethics The risk retention group shall adopt and disclose a code of business conduct and ethics for directors, officers and employees and promptly disclose to the board of directors any waivers of the code for directors or executive officers, which should include the following topics:
- A) conflicts of interest;
 - B) corporate opportunities;
 - C) confidentiality;
 - D) fair dealing;
 - E) protection and proper use of risk retention group assets;
 - F) compliance with all applicable laws, rules and regulations; and
 - G) requiring the reporting of any illegal or unethical behavior which affects the operation of the risk retention group.
- 7) Reporting Non-Compliance The captive manager or chief executive officer of the risk retention group shall promptly notify the domestic regulator in writing if either becomes aware of any material non-compliance with any of the risk retention group's governance standards.
- 8) Enforcement The risk retention group's domestic regulator may take appropriate regulatory action against any director or officer of the risk retention group or its captive manager, pursuant to its laws and regulations, if the risk retention group or captive manager violates these governance standards.

Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers

- I. Permitted Reinsurance
 - A. Risk retention groups shall not receive statement credit if all policies are ceded through one hundred percent (100%) reinsurance arrangements or another lesser percentage as required in the discretion of the Commissioner; and
 - B. Credit for reinsurance will be permitted if the reinsurer complies with [insert applicable section number] of the [insert name of state's substantially similar Credit for Reinsurance Model Law]; or
 - C. Credit for reinsurance may be permitted if the reinsurer maintains an A- or higher A.M. Best rating, or other comparable rating from a nationally recognized statistical rating organization, and the reinsurer maintains a minimum policyholder surplus in an amount acceptable to the Commissioner based upon a review of the reinsurer's most recent audited financial statements; and the reinsurer is licensed and domiciled in a jurisdiction acceptable to the Commissioner; or
 - D. Credit for reinsurance may be permitted if the reinsurer satisfies all of the following requirements and any other requirements deemed necessary by the Commissioner:
 - (1) The captive manager or risk retention group licensed as a captive insurer shall file annually, on or before June 30, or at the request of the Commissioner or if the captive manager or risk retention group thinks it appropriate to file more often, the reinsurer's audited financial statements, which shall be analyzed by the Commissioner to assess the appropriateness of the reserve credit or the initial and continued financial condition of the reinsurer;
 - (2) The reinsurer shall demonstrate to the satisfaction of the Commissioner that it maintains a ratio of net written premium, wherever written, to surplus and capital of not more than 3 to 1;
 - (3) The affiliated reinsurer shall not write third-party business without obtaining prior written approval from the Commissioner;
 - (4) The reinsurer shall not use cell arrangements without obtaining prior written approval from the Commissioner;
 - (5) The reinsurer shall be licensed and domiciled in a jurisdiction acceptable to the Commissioner; and

- (6) The reinsurer shall submit to the examination authority of the Commissioner.
- II. The Commissioner shall either require a reinsurer not domiciled in the US to include language in the reinsurance agreement that states that in the event of the reinsurer's failure to perform its obligations under the terms of its reinsurance agreement, it shall submit to the jurisdiction of any court of competent jurisdiction in the US or shall require compliance with section III below.
- III. For credit for reinsurance and solvency regulatory purposes, the Commissioner may require an approved funds-held agreement, letter of credit, trust or other acceptable collateral based on unearned premium, loss and LAE reserves, and IBNR.
- IV. Upon application, the Commissioner may waive either of the reinsurance requirements in sections I.D.(2) or I.D.(6) in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the Commissioner that the reinsurer is sufficiently capitalized based upon an annual review of the reinsurer's most recent audited financial statements, the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the Commissioner, and the proposed reinsurance agreement adequately protects the risk retention group licensed as a captive insurer and its policyholders. Any such waiver should be included in the plan of operation, or any subsequent revision or amendment of the plan, pursuant to Section 3902(d)(1) of the Federal Liability Risk Retention Act of 1986 and the plan must be submitted by the risk retention group licensed as a captive to the Commissioner of its state of domicile and each State in which the risk retention group licensed as a captive intends to do business or is currently registered. Any such waiver of a section I.D. requirement constitutes a change in the risk retention group's plan of operation in each of those states.
- V. Upon application, the Commissioner may waive the requirement in section II above that a reinsurance arrangement must satisfy either section II or III in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the Commissioner that the reinsurer is sufficiently capitalized based upon an annual review of the reinsurer's most recent audited financial statements, the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the Commissioner, and the proposed reinsurance agreement adequately protects the risk retention group licensed as a captive insurer and its policyholders. Any such waiver should be disclosed in Note 1 of the risk retention group's annual statutory financial statement.

- VI. Each approved captive manager or risk retention group licensed as a captive insurer shall assess the reinsurance programs of the risk retention groups licensed as captives under their management, and within 60 days of the effective date of these guidelines, submit a written report to the Commissioner indicating whether such risk retention groups licensed as captives are in compliance with these guidelines. All risk retention groups licensed as captive insurers that fail to submit the report in a timely manner shall be examined, at the risk retention group's expense, to determine compliance with these guidelines.
- VII. These guidelines are effective __[INSERT DATE]__ and apply to risk retention groups licensed as captive insurers. Risk retention groups licensed as captive insurers who require additional time to comply with these guidelines shall be permitted to take credit for reinsurance for risks ceded to reinsurers not in compliance with these guidelines for a period not to exceed twelve (12) months from the effective date of these guidelines upon satisfactory demonstration to the Commissioner that such delay of implementation will not cause a hazardous financial condition or potential harm to its member policyholders.
- VIII. "Commissioner" refers to the commissioner of the state of domicile of the RRG licensed as a captive.



August 11, 2009

Scott Richardson, Commissioner
State of South Carolina
Chair, NAIC Risk Retention Group Task Force
2301 McGee Street, Suite 800
Kansas City, MO 64108
Attention: Julie Glaszczak [jglaszcz@naic.org]

Re: Application of Risk Retention Group Standards to State Actions

Dear Commissioner Richardson:

The purpose of this letter is to respectfully request that the NAIC amend the accreditation standards developed for the regulation of risk retention groups ("RRGs") to promote state compliance with the legal requirements of the Liability Risk Retention Act ("LRRA" or the "Act"), 15 U.S.C. § 3901, *et seq.*, and the interpretation of the Act's requirements by the NAIC Risk Retention and Purchasing Group Handbook ("Handbook"). As set forth in more detail below, numerous states violate the Act and the directives of the Handbook, and, thereby, violate federal law and frustrate the intent of Congress.

Following the issuance in 2005 of the General Accountability Office's Report on RRGs,¹ the NAIC appointed two working groups – the Risk Retention (C) Working Group and the Risk Retention (E) Task Force. Over the course of the next several years, these groups worked hard to first study the regulation of RRGs in light of the GAO's analysis and then to develop model rules and accreditation standards which would improve their regulation.

The Working Group finished its efforts first and adopted corporate governance standards. The full "C" Committee has recently agreed to examine the method by which those standards should be implemented. The Task Force engaged in a much more lengthy process and recently completed its review and proposed amendment of the Part A, B, and C accreditation standards in the context of RRGs.

Both the Working Group and Task Force were exemplary in their transparency and willingness to receive comment from and work with interested parties from the risk retention and

¹ Risk Retention Groups: Common Regulatory Standards and Greater Member Protections are Needed (GAO-05-536, August 15, 2005).

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alternative risk industry. NRRA was a very active participant in all of these activities, including the NAIC quarterly meetings and interim conference calls.

While the efforts of both the Working Group and the Task Force will have the effect of enhancing the consistency of RRG regulation by the states, there has been no effort to include within the accreditation standards any requirement that the states conform to the Act. A summary of the issues follows.

Background and Legal Analysis

Under the LRRA, in order to do business in a non-domiciliary state, a risk retention group is only required to submit to that non-domiciliary state a filing containing the information delineated in Section 3902(d) of the LRRA.² The LRRA expressly preempts any other non-domiciliary state regulation unless it falls within one of the specified exceptions to preemption under Section 3902(a)(1). 15 U.S.C. § 3902(a). The exceptions to preemption relate primarily to unfair trade practices, premium taxes, registration of an agent, injunctions from a court of competent jurisdiction, and a notice on policies informing policyholders that the RRG may not be subject to all of the insurance laws of the state and is not a member of the state guaranty fund. *Id.* at § 3902(a)(1).

Despite these provisions of the LRRA, many states currently impose a variety of filing, fee, informational response and approval requirements on non-domiciliary RRGs. For instance, the California Department of Insurance requires foreign RRGs to (1) wait 60 days after delivery of its registration filing before it may commence operation in the state, (2) file a recurring annual registration renewal, (3) pay registration and renewal fees, (4) submit additional information as conditions for the Department's "approval," and (4) make changes to documents filed and

² That section provides as follows:

- (d) Each risk retention group shall submit –
-
- (2) to the insurance commissioner of each State in which it intends to do business, before it may offer insurance in such state –
- (A) a copy of such plan or study (which shall include the name of the State in which it is chartered and its principal place of business); and
- (B) a copy of any revisions to such plan or study as provided in paragraph (1) (B) (which shall include any change in the designation of the State in which it is chartered); and
- (3) to the insurance commissioner of each State in which it is doing business, a copy of the group's annual financial statement submitted to the State in which the group is chartered as an insurance company. . . .

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approved in the RRG's domiciliary state before the Department will "approve" the RRG's registration in California. For additional examples, please see the attached chart (Appendix A).³

These practices violate the LRRRA. Two federal court decisions expressly concur with this position: *Attorney's Liability Assurance Society, Inc. v. Fitzgerald*, 175 F. Supp. 2d 619 (W.D. Mich. 2001) and *National Risk Retention Association v. Brown*, 927 F. Supp. 195 (M.D. La. 1996).

In *Fitzgerald*, the court rejected a non-domiciliary state's attempt to regulate foreign RRGs. First, the court found that the state improperly concluded that the foreign RRGs did not qualify as RRGs under the LRRRA. *Fitzgerald*, 175 F. Supp. 2d at 629-34. Secondly, the court found that the LRRRA preempted a regulatory fee which the non-domiciliary state attempted to assess against foreign RRGs. *Id.* at 636. Specifically, the court found:

The LRRRA's purpose would be thwarted if every state could exact a regulatory fee from non-resident risk retention groups. . . . Congress could have provided an exception for non-chartering states to collect a fee, over and above allowing collection of premium taxes. But it did not, which requires the conclusion that the regulatory fee was preempted.

Id. Thus, the court recognized the importance of limiting the regulatory powers of non-domiciliary states as Congress intended under the LRRRA.

In *Brown*, a non-domiciliary state attempted to impose requirements not specified in Section 3902(d) of the LRRRA as conditions for foreign RRG registration. The conditions included a required minimum capital and surplus of \$5 million, posting of funds or a bond of \$100,000 with the commissioner, and an annual submission of a plan of operation along with a \$1,000 examination fee. The court held that the non-domiciliary state exceeded its authority over foreign RRGs:

The burden imposed by the application process for a non resident risk-retention group is broader than is allowed by the LRRRA. Section 3902(d) sets out the documents which are to be submitted to the insurance commissioner in the state in which it intends to do

³ Appendix A summarizes those state actions which occur frequently. Other actions – such as challenges to a RRGs capitalization, informational reporting requirements, challenges regarding "financial responsibility" laws, challenges based upon the definition of a "liability" and others – occur occasionally and generally relate to specific state laws and, therefore, need to be treated on a case-by-case basis.

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business but is not chartered . . . risk retention groups are exempted from any further requirements under Section 3902(a)(1).

Brown, 927 F. Supp. at 201. Accordingly, unless a specific regulatory power has been conferred upon a non-domiciliary state under the LRRRA, Section 3902 prohibits the non-domiciliary state from directly or indirectly regulating the RRG.

NAIC Handbook

The NAIC recognizes that non-domiciliary states cannot utilize the registration process to regulate RRGs beyond the scope that the LRRRA permits. Section II, 2.(a), of the NAIC's Risk Retention and Purchasing Group Handbook (rev. 1999) states:

Section 3902(a)(1)(D) of the LRRRA provides that any state may require that a RRG doing business in the state register with and designate the insurance commissioner of each state in which it does business as the group's agent for the purpose of receiving service of legal documents or process. Registration is intended to provide states with an orderly mechanism to identify RRGs operating within their borders. *Registration is not intended to provide non-chartering states with any regulatory powers over RRGs other than that provided in the LRRRA.*

(emphasis added).

The Handbook further elaborates upon the limitations of the non-domiciliary state's authority and the role of the chartering or "lead" state in Section A.1.(a)(i):

A chartering state should recognize that, due to the preemption of many state laws with respect to RRGs, non-chartering states depend on the domestic state to perform background checks on directors, officers and key management personnel of a RRG to ensure the competency, character and integrity of the insurer's management. As the lead regulator, the chartering state can help satisfy the legitimate concerns of non-chartering states with respect to the directors, officers and management of a RRG by conducting these background checks. Such action by the chartering state eliminates the need for redundant regulatory functions and is consistent with both the letter and intent of the LRRRA.

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Section A.1.(a)(ii) again emphasizes the same theme:

Due to the preemption of many state laws with respect to RRGs, non-chartering states rely on the accuracy and completeness of the chartering state's review of a RRGs application. [See (i) above.] Requests for information outside of that required by the LRRRA can be challenged by a RRG. [See (iii) below.] It is in the interest of both regulators and RRGs to avoid utilizing scarce resources for overlapping regulation.

The Handbook also prohibits the assessment of fees:

The relevant portion of the LRRRA for purposes of determining whether states can charge registration and other fees provides as follows: "any State may require [a risk retention group] to pay, on a nondiscriminatory basis, applicable premium and other taxes which are levied on admitted insurers and surplus lines insurers..." 3902(a)(1)(B). This language used in the LRRRA does not specifically mention or authorize non domiciliary state to charge "fees."

Handbook, Section II.A.4.

This same section of the Handbook notes the Brown decision and advises:

The court in the recent case of NRRA v. Brown found that the LRRRA does not authorize a non-domiciliary state to charge fees. The court in that case held that non-domiciliary states could not *assess annual, application or policy form review fees* against a risk retention group domiciled in another state. Given the language in the LRRRA and this most recent case, States are urged to have counsel review their state law assessment provisions to determine their permissibility under the LRRRA.

Id. (emphasis in original).

As set forth in Appendix A, numerous states consistently ignore the NAIC Handbook and the requirements of federal law.



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Impact on Consumers and RRGs

The financial impact of state regulatory practices on RRGs has been substantial. According to a recent survey by *The Risk Retention Reporter*, an industry journal, for an RRG operating in all states, the annual cost for registration fees is approximately \$9,300, and the cost is \$8,500 for annual renewal, filing, and/or other fees. "Impact on Risk Retention Groups of State Encroachment of Liability Risk Retention Act Preemptions," *The Risk Retention Reporter*, Jan. 2009, at 8. Moreover, states that impose approval and requirements beyond the scope of the LRRRA force RRGs to incur significant compliance and legal costs to satisfy individual state regulators' demands.

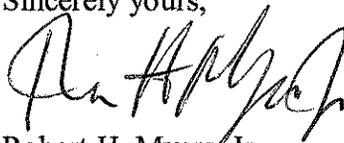
The results of the *Risk Retention Reporter's* survey, which received responses from captive managers representing 118 RRGs, demonstrate that state regulatory violations of the LRRRA are prevalent. Sixty-one percent of survey respondents reported that states had "overreached" by attempting to directly or indirectly regulate the operation of a foreign RRG. The responses indicated that 39 states engage in some form of overreaching.

Conclusion

State regulatory practices in violation of the LRRRA not only impose significant financial burden on RRGs but also stymie Congress' intent to encourage the formation of RRGs to provide affordable liability coverage. NRRA respectfully requests that the NAIC review states' compliance with the LRRRA and the Handbook and add to the accreditation standards provisions that will encourage states to conform to the law.

Thank you in advance for your consideration of this request.

Sincerely yours,



Robert H. Myers, Jr.
General Counsel
National Risk Retention Association
(202) 898-0011
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RHM:hmb



APPENDIX

SUMMARY OF STATE VIOLATIONS OF THE LRRRA

Initial Registration Requirements

- The majority of states charge an initial registration fee
- Four states charge an initial registration fee equal to or greater than \$1000 (Alaska, California, Louisiana, and South Carolina)
- Several states require “review” or “approval” process spanning a few months to a few years before registration is effective (including California, Florida, North Carolina, New Jersey and Texas)

Annual Registration

- Over a dozen states require an annual “renewal fee,” ranging from \$100-\$1,000, often in addition to an annual statement or “maintenance” filing fee, ranging from \$50-\$300
- Several states require filing state-specific renewal form (including Alabama, California, Massachusetts, Mississippi, North Dakota, and Ohio)

Other Fees/Requirements

- Many states require medical malpractice RRGs to file claims reports either quarterly or annually (including Illinois, Montana, and Washington)
- Several states require other fees, e.g., fraud program fees, desk audit fees, renewal certificate of authority fees



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Securities and Health Care Administration
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Health Care Admin.: 1-800-631-7788
Securities: 1-877-550-3907

September 10, 2009

Julie Glaszczak, CPA, FLMI, ARA
National Association of Insurance Commissioners
Senior Accreditation Manager
Kansas City, MO 64108

Re: Part A Accreditation Standards

Dear Julie:

As discussed on the most recent Risk Retention Group Task Force conference call, please find a few follow up questions regarding the Part A Accreditation Standards:

2. Capital and Surplus Requirements

Risk-Based Capital – Vermont has always used RBC only as an analytical tool, although we have required our RRG's to file RBC with VT and the NAIC. The Task Force has since agreed that RBC is not applicable to RRG's. If my memory serves me correctly, the intention of the Task Force was to still require RRG's to file RBC, domiciles will use it as an analytical tool, and RRG's will continue to file it with the NAIC? Or is RBC no longer a required filing for RRG's?

6. Holding Company Systems

Does an RRG need to file Holding Company filings only with its state of domicile, or with other states?

The Part A Summary Memo states "During its discussion of the Part B accreditation standards, the Task Force will address the issue of communication to other states as it relates to items such as exemptions to the model requirements based on disclaimer of affiliation. It should be discussed whether this communication should just indicate that an exemption was granted or also indicate why an exemption was granted." If we discussed this during Part B, I can't remember what we decided?



I'm also having a little trouble figuring out when an RRG would file for an exemption with a "disclaimer of affiliation". Would the following hypothetical example be a candidate for filing for a disclaimer of affiliation exemption?

An RRG is owned equally by 5 different hospitals. Each hospital owns 20%. Since ownership is greater than 10%, the Holding Company rules apply. Since all owners have an equal share, no one hospital can exercise any undue influence over the RRG. Each hospital has only one board member, all board members have an equal vote, the board runs the company, and therefore no one person can exercise control.

Any other hypothetical examples the Task Force could provide would be helpful.

10. Reinsurance Ceded - Reinsurance Guidelines for Risk Retention Groups

1.C. "Credit for reinsurance may be permitted if the reinsurer maintains an A- or higher A.M. Best rating, or other..."

I assume that if a domicile permits credit for reinsurance based on a reinsurer being A rated, and the rating subsequently drops below an A rating, that the reinsurance credit would not automatically be removed. The reinsurer may still meet the criteria under 1.D. If the reinsurer subsequently fails to meet the criteria under 1.D., the RRG could not place any new reinsurance with the reinsurer. Reinsurance credit could still be permitted on the past business if the reinsurance continued to be deemed collectable?

On that same note, if a RRG is currently using a reinsurer that may not meet the new guidelines effective 1/1/2011, the reinsurance credit would not automatically be removed effective 1/1/2011. The RRG could not place any new reinsurance with the reinsurer. Reinsurance credit could still be permitted on the past business if the reinsurance continued to be deemed collectable?

IV. "Any such waiver of a section I.D. requirement constitutes a change in the risk retention group's plan of operation in each of those states."

Was the intention of this to require the RRG to file the waiver, or change in plan of operation, with all the states that it is registered in?

11. CPA Audits

Requires audited statements to be filed before June 1. Vermont requires the audited financial statements be filed by June 30th. If I remember correctly, the Task Force agreed that June 30th would be considered "substantially similar"?

Thank you for the opportunity to ask further questions regarding the Part A Accreditation Standards. Feel free to call me at (802) 828-3304 should you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Peter Raymond".

Peter Raymond, CFE, CPA
Director of Captive Insurance
Vermont Captive Insurance Division

cc: David Provost, Vermont Deputy Commissioner

**EXCERPTS FROM THE
ANNUAL FINANCIAL REPORTING MODEL REGULATION**

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Section 3. Definitions

The terms and definitions contained herein are intended to provide definitional guidance as the terms are used within this regulation.

- A. "Accountant" or "independent certified public accountant" means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants (AICPA) and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.
- B. An "affiliate" of, or person "affiliated" with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
- C. "Audit committee" means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or Group of insurers, and audits of financial statements of the insurer or Group of insurers. The Audit committee of any entity that controls a Group of insurers may be deemed to be the Audit committee for one or more of these controlled insurers solely for the purposes of this regulation at the election of the controlling person. Refer to Section 14E for exercising this election. If

an Audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the Audit committee.

- D. "Audited financial report" means and includes those items specified in Section 5 of this regulation.
- E. "Indemnification" means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing of other misrepresentations made by the insurer or its representatives.
- F. "Independent board member" has the same meaning as described in Section 14C.
- G. "Insurer" means a licensed insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law or an authorized insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law.
- H. "Group of insurers" means those licensed insurers included in the reporting requirements of [insert state law equivalent of the model Insurance Holding Company System Regulatory Act], or a set of insurers as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.
- I. "Internal control over financial reporting" means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and includes those policies and procedures that:
 - (1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;
 - (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and
 - (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements, i.e., those items specified in Section 5B through 5G of this regulation.
- J. "SEC" means the United States Securities and Exchange Commission.
- K. "Section 404" means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.
- L. "Section 404 Report" means management's report on "internal control over financial reporting" as defined by the SEC and the related attestation report of the independent certified public accountant as described in Section 3A.
- M. "SOX Compliant Entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-

Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

Section 4. General Requirements Related to Filing and Extensions for Filing of Annual Audited Financial Reports and Audit Committee Appointment

- D. Every insurer required to file an annual Audited financial report pursuant to this regulation shall designate a group of individuals as constituting its Audit committee, as defined in Section 3. The Audit committee of an entity that controls an insurer may be deemed to be the insurer's Audit committee for purposes of this regulation at the election of the controlling person.

Section 7. Qualifications of Independent Certified Public Accountant

- J. All auditing services and non-audit services provided to an insurer by the qualified independent certified public accountant of the insurer shall be preapproved by the Audit committee. The preapproval requirement is waived with respect to non-audit services if the insurer is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity or:

- (1) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;
- (2) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and
- (3) The services are promptly brought to the attention of the Audit committee and approved prior to the completion of the audit by the Audit committee or by one or more members of the Audit committee who are the members of the board of directors to whom authority to grant such approvals has been delegated by the Audit committee.

Section 14. Requirements for Audit Committees

This section shall not apply to foreign or alien insurers licensed in this state or an insurer that is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity.

- A. The Audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements between management and the accountant regarding financial reporting) for the purpose of preparing or issuing the Audited financial report or related work

pursuant to this regulation. Each accountant shall report directly to the Audit committee.

- B. Each member of the Audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected pursuant to Subsection E and Section 3C.
- C. In order to be considered independent for purposes of this section, a member of the Audit committee may not, other than in his or her capacity as a member of the Audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. However, if law requires board participation by otherwise non-independent members, that law shall prevail and such members may participate in the Audit committee and be designated as independent for Audit committee purposes, unless they are an officer or employee of the insurer or one of its affiliates.
- D. If a member of the Audit committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the responsible entity to the state, may remain an Audit committee member of the responsible entity until the earlier of the next annual meeting of the responsible entity or one year from the occurrence of the event that caused the member to be no longer independent.

Drafting Note: In determining independence, the commissioner shall consider utilizing guidance provided in the SEC's Final Rule No. 33-8220, *Standards Relating to Listed Company Audit Committees* adopted April 9, 2003.

- E. To exercise the election of the controlling person to designate the Audit committee for purposes of this regulation, the ultimate controlling person shall provide written notice to the commissioners of the affected insurers. Notification shall be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded.
- F. (1) The Audit committee shall require the accountant that performs for an insurer any audit required by this regulation to timely report to the Audit committee in accordance with the requirements of SAS 61, *Communication with Audit Committees*, or its replacement, including:
 - (a) All significant accounting policies and material permitted practices;
 - (b) All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and
 - (c) Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.
- (2) If an insurer is a member of an insurance holding company system, the reports required by Subsection F(1) may be provided to the Audit committee on an aggregate basis for insurers in the holding company system, provided

that any substantial differences among insurers in the system are identified to the Audit committee.

- G. The proportion of independent Audit committee members shall meet or exceed the following criteria:

Prior Calendar Year Direct Written and Assumed Premiums		
\$0 - \$300,000,000	Over \$300,000,000 - \$500,000,000	Over \$500,000,000
No minimum requirements. See also Note A and B.	Majority (50% or more) of members shall be independent. See also Note A and B.	Supermajority of members (75% or more) shall be independent. See also Note A.

Note A: The commissioner has authority afforded by state law to require the entity's board to enact improvements to the independence of the Audit committee membership if the insurer is in a RBC action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.

Note B: All insurers with less than \$500,000,000 in prior year direct written and assumed premiums are encouraged to structure their Audit committees with at least a supermajority of independent Audit committee members.

Note C: Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

- H. An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than \$500,000,000 may make application to the commissioner for a waiver from the Section 14 requirements based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from Section 14 with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.