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MARKET REGULATION REFORMS

An NAIC Issues Brief

The Issue: State insurance regulators have been criticized for the patchwork quilt of different market regulation statutes and systems currently in use. They are working to implement an efficient, uniform and national market regulatory process while preserving local control over matters that directly affect consumers within each state.

Overview: Market regulation has only recently begun the process of comprehensive reform that financial regulation went through in the late 1980s and early 1990s. Its evolution has led to the use of examinations as the primary method of regulation, with state-specific application of examination standards. While market regulation must be state-specific for certain issues, there is an ongoing desire for it to function through uniform, national standards. However, there are competing visions regarding the focus of market regulation.

The insurance industry continues to seek more efficient regulation and push for tighter guidelines and accountability on market regulatory processes. For example, the insurance industry believes that market regulation should focus on unfair trade practices that reflect general business practices of insurers, rather than focusing on infrequent or unintentional random errors that do not cause significant harm to consumers.

On the other hand, insurance consumers want insurance regulators to have more resources and better tools beyond examinations for protecting consumers. Consumer representatives would like to see a more rigorous and robust system of data collection and analysis that allows insurance regulators to continually monitor the marketplace through a centralized national database. This type of system would enhance the current examination methodology by providing state insurance regulators with additional insights about which companies should be further scrutinized and in what areas.

This *Issues Brief* will address the efforts of state insurance regulators working through the NAIC to establish an efficient, uniform and national market regulatory process that maintains state-to-state differences when appropriate.

NAIC Position: The NAIC recognizes that the sales and administration of insurance policies are generally best regulated by the marketplace; however, there are instances, such as improper claim settlements, where the marketplace does not respond properly to actions that are not in the best interests of its participants. A strong and reasonable market regulation program will discover these situations, thereby allowing regulators to respond and act appropriately to influence company behavior. In 2003, state insurance regulators established market analysis, market conduct, and interstate collaboration as the three pillars on which the states' enhanced market regulatory system would rest.

States have taken concrete steps toward the creation of a more systematic, structured and uniform market analysis program. In 2008, the NAIC membership agreed that all states should use the market conduct annual statement to collect summary data on key company functions, such as the timeliness of claim payments and policy replacements, and that all data should be collected and stored in a national database at the NAIC. Currently, 29 states use the market conduct annual statement.

To promote collaboration between states, insurance regulators formed the Market Actions Working Group (MAWG) to facilitate the sharing and coordination of the states' market analysis and regulatory efforts. MAWG analyzes regulated entities showing signs that could indicate the presence of current or future market regulatory issues that would impact multiple jurisdictions.

Lastly, state insurance regulators have been working to establish a minimum set of standards for state regulatory functions in the areas of market analysis, data collection, market conduct examinations, and interstate collaboration. These standards will allow states to use consistent methodologies and processes, while also allowing the flexibility to deal with state-specific requirements as needed.

Background: Congress has expressed concern regarding the need for states to improve the quality and uniformity of insurance market regulation. In 2003, the General Accounting Office (GAO) issued a report titled, "Insurance Regulation—Common Standards and Improved Coordination Needed to Strengthen Market Regulation." The GAO conducted this study because of its recognition that:

> Market regulation is hindered by limited resources, a lack of emphasis on important regulatory tools and the framework of the systems itself, which requires individual states to oversee companies that operate in many states or nationwide. As a result, market regulation is currently based on overlapping and often inconsistent state policies and activities. While it provides some oversight, it may also place an undue burden on some insurance companies and, at times, may fail to adequately protect consumers.

During the same time period, state insurance regulators adopted their comprehensive Insurance Regulatory Modernization Action Plan. Through this plan, state insurance regulators established market analysis, market conduct, and interstate collaboration as the three pillars of the states' enhanced market regulatory system.

In addition, the National Conference of Insurance Legislators (NCOIL), through the Insurance Legislators Foundation, conducted a study in 2003 titled, "The Path to Reform—The Evolution of Market Conduct Surveillance Regulation." This study recommended that the domiciliary regulator be given the primary responsibility for performing market conduct surveillance, and for states to engage in proactive dialogue with insurers on new laws, regulations, and recent enforcement actions. The report also called for the development of a model law on market conduct surveillance to establish the statutory basis for new surveillance techniques.

In 2004, the NAIC and NCOIL jointly adopted a Market Conduct Surveillance Model Act (#693). This model establishes a framework for the following market conduct actions:

- Processes and systems for identifying, assessing and prioritizing market conduct problems.
- Actions a commissioner can take to substantiate and remedy market conduct problems.
- Procedures to communicate and coordinate market conduct actions among jurisdictions to promote the most efficient and effective use of resources.

In 2006, NCOIL revised the model act to provide for greater domestic deference. The revision also required state regulators to give insurers the opportunity to resolve any matters identified through market analysis themselves before market conduct action could be taken against them.

The market conduct annual statement started as a pilot project in 2002 and was made a permanent project in 2004. It was created to collect summary data on key company functions and to promote uniform analysis among states. This allows regulators to identify concerns regarding the timeliness of claim payments and policy replacement counts. In 2008, the NAIC adopted a position that all states should use the market conduct annual statement, and that the data should be collected and stored in a central, national database at the NAIC. This is a significant step, as such centralized data will allow more types of analysis to be performed by NAIC support staff and regulators. Today, 29 states use the annual statement.

In addition to the market conduct annual statement, the NAIC developed specific market analysis guidelines designed to provide tools for each state to review its entire market, identify companies operating in that market that are potentially harming consumers, and assist in narrowing the scope of regulatory action against those companies that appear to be experiencing compliance problems.

To formally document analysis and examination procedures, the NAIC combined the previously published *Market Analysis Handbook* and *Market Conduct Examiners Handbook* into one comprehensive publication—the *Market Regulation Handbook*. The purpose of this Handbook is to assist states in using insurance department resources, to eliminate duplicative inquiries, and to provide guidance on how to coordinate market regulation among states. Handbook chapters explain the basic framework for market analysis, general examination standards, the multi-state examination process, and examination standards for specific lines of insurance.

All of these efforts aim to improve efficiency and promote uniformity in state-based market regulation. However, some processes and statutes must differ from state to state. While market regulation focuses on legal obligations and responsible business practices, a company's own operations and the legal environment in which it operates may vary considerably from state to state. For example, coastal states that face the threat of hurricanes have implemented specific insurance regulations to address consumer issues related to this risk. In addition, the demographics of state populations vary, which can also lead to varying state laws and regulations. These types of differences are better addressed through a process that preserves local control over matters that directly affect consumers within each state.

There continue to be divergent viewpoints regarding the best method of implementing a uniform, national system of market regulation that creates greater consistency among state regulators, and also maintains and enhances consumer protection. The proposed solutions continue to focus on the role of domiciliary state deference, data collection and market analysis, and a range of regulatory interventions that extends beyond examinations. The states are working collaboratively through the NAIC to achieve the most efficient and uniform national market regulatory process possible to protect consumers while still maintaining local control over matters that reflect important differences in need and environment from state to state.