Navigating the Regulatory Alphabet Soup

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The insurance industry currently faces a fast-growing array of new regulations and reforms promulgated in response to the 2008 global financial crisis. Although the U.S. insurance regulatory system proved successful through the financial crisis, the crisis was the largest shock to the financial system since the Great Depression and spawned numerous regulatory responses at the state, federal and international levels. These responses have given rise to a plethora of new insurance regulatory acronyms: there is now IAIG, G-SII, HLA, FIO, and ORSA, just to name a few, and not to mention related abbreviations such as ComFrame. Moreover, there are many insurance acronyms that continue to make news headlines, such as TRIA and NARAB, due to their implications or needed regulatory changes.

To the casual observer, these acronyms and abbreviations can be intimidating and start to look more like a bowl of alphabet soup. This article attempts to clarify some of these insurance regulatory buzz words and their significance within insurance regulation and is an update to a previous article that appeared in the October 2011 CIPR Newsletter titled, “Know Your ABCs … It’s Still Relevant.”

**ICPs**

Formed in 1994, the International Association of Insurance Supervisors (IAIS) is the international standard-setting body for the insurance industry. Its members constitute nearly all of the world’s insurance supervisors. Since its inception, the IAIS has worked to promote effective and globally consistent supervision of the insurance industry and to contribute to global financial stability. The IAIS has no regulatory power or legal authority, but it influences national and regional regulators by publishing supervisory principles, offering training and support, and advancing the latest developments in international regulation.

Insurance Core Principles (ICPs) were developed by the IAIS to provide a globally accepted framework for the regulation and supervision of the insurance sector. The ICPs prescribe the essential elements that must be present in the supervisory regime in order to promote a financially sound insurance sector and provide an adequate level of policyholder protection. They are applicable to the supervision of all insurers and insurance groups, regardless of their size, international orientation or systemic importance.

The ICPs were first issued in 1997 and have been revised several times, most recently in October 2011. There are currently 26 ICPs that cover a range of subjects, including licensing, suitability of persons, corporate governance, risk management, reinsurance, group-wide supervision and cross-border cooperation. While the ICPs are not binding on IAIS-member jurisdictions, they are used in the evaluation of supervisory regimes under the Financial Sector Assessment Program (FSAP) conducted jointly by the World Bank and the International Monetary Fund, where the financial sector regulatory frameworks of a jurisdiction are assessed against the appropriate international standards. For insurance, the ICPs form the basis for the assessment of insurance regulators’ observance of international standards.

**ComFrame**

The regulation of insurance groups has garnered considerable attention following the financial crisis, with various regulatory agencies developing new guidelines and requirements for the supervision of financial holding companies. In the U.S., the Solvency Modernization Initiative (SMI), which began in June 2008, has led to substantive changes regarding how insurance groups will be monitored and regulated in the coming years, including amendments to the Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450). Globally, however, the most significant development regarding group supervision is a major project initiated at the IAIS known colloquially as ComFrame (Common Framework for the Supervision of Internationally Active Insurance Groups).

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ComFrame is a set of international supervisory requirements focusing on the effective group-wide supervision of internationally active insurance groups (or IAIGs, discussed in more detail below). It is built on the premise that IAIGs—the largest and most complex insurance groups—should be supervised in a collaborative fashion by home and host supervisors, thereby resulting in more effective and efficient supervision. ComFrame will provide a framework to assist supervisors in addressing the risks arising in IAIGs. The IAIS notes IAIGs need tailored and more coordinated supervision across jurisdictions due to their complexity and international activity, which necessitates a specific framework to assist supervisors in collectively addressing group-wide activities and risks, identifying and avoiding regulatory gaps and coordinating supervisory activities under the aegis of a group-wide supervisor.

ComFrame is built and expands upon the high level requirements and guidance currently set out in the ICPs. It is currently structured in three modules, with each module made up of a number of standards (referred to as “elements”). Module 1, Scope of ComFrame, includes the criteria and process for the identification of IAIGs by supervisors, the breadth of supervision of IAIGs (i.e., which legal entities are included) and the identification of the group-wide supervisor. Module 2, The IAIG, contains the requirements that an IAIG will need to meet. Module 3, The Supervisors, covers the process of supervision, highlighting the role of the group-wide supervisor and other relevant supervisors’ responsibilities within the process. This module covers the supervisory process, enforcement, cooperation and interaction requirements.

The development phase of ComFrame began in 2010 and concluded at the end of 2013, with several ComFrame drafts released for public consultation during this period. Comments received have been referred to various IAIS subcommittees and working groups to improve and refine the document. ComFrame is currently being field tested to assess the value and practicality of the various requirements, so it can be modified as necessary prior to formal adoption. The IAIS currently plans to formally adopt ComFrame by the end of 2018, with implementation by its members thereafter.

• IAIG

An internationally active insurance group (IAIG) is a term under ComFrame for insurance groups or financial conglomerates that exceed thresholds on international activity and size. The IAIS has set out proposed criteria relevant supervisors will use for identifying an IAIG, but allowing a degree of supervisory discretion to local regulators as to whether a particular group should or should not be categorized as an IAIG. Under the proposed criteria, to be an IAIG, an insurance group must write at least 10% of its total gross written premiums outside its home jurisdiction and must write premiums in three or more jurisdictions. In addition, the insurance group must have assets of at least $50 billion or premiums of at least $10 billion of a three-year rolling average.

Supervisory colleges are intended to facilitate oversight of IAIGs at the group level and will be the mechanism by which an IAIG is identified. U.S. state insurance regulators both participate in and convene supervisory colleges. The IAIS expects there may be approximately 50 groups that could be considered IAIGs under the proposed criteria.

• G-SII

The severity of the financial crisis underscored the interconnected nature of financial institutions, as well as the risks they pose to the financial system when they are in distress. Phrases like “too big to fail” and “systemically important” continuously made news headlines in the midst of the crisis. The Financial Stability Board (FSB) was established in 2009 and tasked by the Group of Twenty (G-20) to develop a framework to address the systemic and moral hazard risk posed by global systemically important financial institutions (G-SIFIs). G-SIFIs are defined by the FSB as “institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries.”

As part of this effort, the IAIS is working with the FSB to identify global systemically important insurers (G-SIIs). A G-SII is one class of G-SIFIs. While the insurance industry was not the root cause of the financial crisis, insurance markets have become increasingly global and interconnected, and activities they engage in have become increasingly tied to the financial markets. As such, the FSB asked the IAIS to set up a process to assess insurers’ systemic riskiness and to recommend policy measures designed to prevent catastrophic failure in the sector.

On July 18, 2013, the IAIS released its final guidance on 1) the assessment methodology the FSB uses to assist in identifying G-SIIs; and 2) the policy measure framework to be applied to such insurers. The assessment methodology

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1 The IAIS defines a supervisory college as “a forum for cooperation and communication between the involved supervisors established for the fundamental purpose of facilitating the effectiveness of supervision of entities which belong to an insurance group; facilitating both the supervision of the group as a whole on a group-wide basis and improving the legal entity supervision of the entities within the insurance group.”
identified five categories to measure relative systemic importance: 1) non-traditional insurance and non-insurance (NTNI) activities; 2) interconnectedness; 3) substitutability; 4) size; and 5) global activity.

According to the IAIS, NTNI activities, the most heavily weighted category, are at the core of systemic risk in the insurance sector, along with the interconnectedness of the insurance business with the wider financial sector. Examples of NTNI activities include credit default swaps transactions for non-hedging purposes or leveraging assets to enhance investment returns. While traditional insurance is not viewed as systemically risky, insurance groups and conglomerates operating in traditional lines of business may suffer considerable distress and become globally systemically important when they expand significantly in non-traditional and non-insurance activities.

The policy measures that apply to G-SIs consist of the following factors: 1) enhanced supervision; 2) effective resolution; and 3) higher loss absorption (HLA) capacity. Concurrent with the release, the FSB announced a list of nine multinational insurance groups it considers to be G-SIs—three in the U.S., five in Europe, and one in China (Figure 1)—and therefore rendered them subject to these additional policy measures. The G-SII list will be determined by the FSB on an annual basis, based on information provided by the IAIS.

In the U.S., the Financial Stability Oversight Committee (FSOC), established under the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) is authorized to address systemic risk and has its own separate process for evaluating and designating systemically important insurers. To date, the FSOC has designated two of the three U.S.-based G-SIs as “systemically significant” and a third insurer is under review.

It is important to note the methodology and related policy measures for G-SIs are separate from ComFrame. Unlike the IAIS work for G-SIs, ComFrame does not directly address systemic risks. As such, the criteria—and purposes—for identifying G-SIs and IAIGs are distinct. The architecture envisioned by the IAIS is illustrated in Figure 2.

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**BCR, HLA and ICS**

There is significant activity currently underway at the IAIS in the area of capital developments for the application to G-SIIs and in conjunction with its work on ComFrame. In July 2013, the FSB directed the IAIS to develop for the purposes of the higher loss absorption (HLA) capacity G-SII policy measure, “straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalized by the end of 2014.” A backstop capital requirement (BCR) will be the first step in the development of HLA requirements to apply to G-SIIs in 2015. According to the IAIS, the HLA will build on the BCR and address additional capital requirements for G-SIIs reflecting their systemic importance in the international financial system.

The IAIS is also currently developing a risk-based global insurance capital standard (ICS), due to be completed by the end of 2016, with full implementation expected in 2019 after two years of testing and refinement with supervisors and global insurance groups. The ICS will be developed within ComFrame and apply to all IAIGs. The IAIS hopes the ICS will provide a more comparable measure of capital across jurisdictions and allow host supervisors to have greater confidence in the group-wide supervisor’s decisions and analysis.

While neither the BCR nor the ICS are expected to replace jurisdictional entity-based insurance capital requirements, there will be continuing discussion at the IAIS about how the ICS might interact with such existing requirements, such as U.S. risk-based capital (RBC) legal entity requirements and RBC ratios. Both are being designed to pick up financial risk and material non-financial risk from all sources within the group, including risk emanating from entities that were heretofore not subject to entity-based regulation.

**FIO**

The Dodd-Frank Act, signed into law by President Barack Obama in July 2010, brought about significant changes to financial regulation in the U.S. The stated aim of the legislation is to promote financial stability by improving accountability and transparency in the financial system, to end “too big to fail” and to protect consumers from abusive financial services practices. The Dodd-Frank Act created new laws in all major segments of the financial services industry, including banks, thrifts, mortgage businesses and insurance.

The Dodd-Frank Act established a new Federal Insurance Office (FIO) within the U.S. Department of the Treasury, led by a director who is appointed by the secretary of the Treasury. The FIO is charged with monitoring all aspects of the insurance sector, including identifying activities within the sector that could potentially contribute to a systemic crisis to the broader financial system, the extent to which underserved communities have access to affordable insurance products, and the sector’s regulation.

The FIO does not have supervisory or regulatory authority over the business of insurance. While the FIO serves an important role by providing necessary expertise and advice regarding insurance matters to the Treasury Department and other federal agencies, it is not a regulatory agency and its authorities do not displace the time-tested robust state-based insurance regulatory regime.

The FIO is responsible for issuing several one-time reports as well as annual reports to the U.S. Congress. In December 2013, the FIO released a mandated study titled “How to Modernize and Improve the System of Insurance Regulation in the United States.” The report acknowledges many of the strengths as well as the successes of state-based insurance regulation.

**ORSA**

In November 2011, as part the SMI, the NAIC voted to adopt a significant new addition to U.S. insurance regulation: the U.S. Own Risk and Solvency Assessment (ORSA). One of the key lessons arising from American International Group’s (AIG) difficulties and its resulting bailout during the financial crisis was the need enhance the area of group supervision. The contagion effects experienced by U.S. insurers in the AIG holding company system’s near collapse caused U.S. insurance regulators to reevaluate their group supervisory framework and pay closer attention to the risks that are created by activities going on outside of those entities as well as the reputational and contagion issues that could exist. Following the crisis, insurance regulators across the globe have been working toward a common goal of improving the processes for understanding and measuring risks inherent in the business of insurance.

In essence, an ORSA is an internal process undertaken by an insurer or insurance group to assess the adequacy of its risk management and current and prospective solvency positions under normal and severe stress scenarios. Each insurer required to complete an ORSA must issue its own assessment of its current and future risks (i.e., underwriting, credit, market, operational, liquidity risks, etc.) that could have an impact on its ability to meet its policyholder obligations, thereby allowing regulators to form an enhanced view of the insurer’s ability to withstand financial stress.

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Pursuant to the NAIC Own Risk and Solvency (ORSA) Guidance Manual and the recently adopted Risk Management and Own Risk and Solvency Assessment Model Act (#505), starting in 2015, an insurer and/or the insurance group of which the insurer is a member will be required to: 1) complete an ORSA at least annually to assess the adequacy of its risk management and current, and likely future, solvency position; 2) internally document the process and results of the ORSA assessment; and 3) provide a high-level summary report annually to the lead state commissioner if the insurer is a member of an insurance group and, upon request, to the domiciliary regulator if the insurer is not a member of a group. Currently, the ORSA requirements apply only to large insurers and large holding companies.

In 2010, the ORSA concept was added to the IAIS list of ICPs. ICP 16: Enterprise Risk Management (ERM) indicates an insurer should perform an ORSA to regularly assess the adequacy of its risk management in supporting the current, and the expected future, solvency positions. ICP 16 applies to “insurance legal entities and insurance groups with regard to the risks posed to them by non-insurance entities.” As a result, an ORSA is now a worldwide standard. In order to comply with the ICPs, all IAIS members are asked to apply ICP 16 in their legal frameworks and supervisory practices.

**TRIA**

The federal Terrorism Risk Insurance Act (TRIA) was passed in response to the 9/11 terrorist attacks, to ensure the continued availability and affordability of commercial terrorism insurance. U.S. insurance markets were caught off guard by the 9/11 terrorist attacks. Loss of life and property led to an estimated $32.5 billion in insured losses—$43 billion in 2013 dollars—the largest figure up to that point. In the wake of the attack, terrorism risk insurance became either extremely expensive or unavailable in the private market.

Since TRIA became law in 2002, it has helped create a federal loss-sharing program to backstop the private insurance markets and to ensure the widespread availability of affordable insurance against terrorism risks. The program requires the government to cover a portion of insured losses from a terrorist attack once losses reach a certain threshold.

TRIA has been reauthorized twice by the U.S. Congress, in 2005 and 2007, and is currently set to expire at the end of this year. The Dec. 31, 2014, sunset is already causing market disruptions. State insurance regulators and the NAIC have supported TRIA since its inception and its subsequent reauthorizations and are committed to working with Congress, the Obama administration, state officials and the industry to develop a long-term plan to help make terrorism insurance available and affordable.

The TRIA reauthorization effort has gained momentum in the past few months. On July 17, 2014, the Senate voted in favor of a bill (S. 2244, the Terrorism Risk Insurance Program Reauthorization Act of 2014) that would continue the program for another seven years and the House Financial Services Committee passed a version of the legislation out of committee on June 24. NAIC members are encouraged by momentum in both the Senate and House and urge prompt congressional action to move a TRIA reauthorization bill forward expeditiously.

**NARAB**

Licensing of insurance agents and brokers (collectively, “producers”) has long been an integral part of the U.S. state-based insurance regulatory system. Historically, each state has had its own producer-licensing requirements. Producers licensed in one state generally had to meet the separate licensing requirements for each state in which they wanted to sell insurance. In 1999, the federal Gramm-Leach-Bliley Act (GLBA) sought to modernize and streamline the variation in state laws dealing with the licensing of insurance producers. The GLBA contained a provision requiring the states to enact certain reforms to the insurance producer-licensing process. The provision would create a private, non-profit licensing body, referred to as the National Association of Registered Agents and Brokers (NARAB), if greater state producer-licensing uniformity or reciprocity was not achieved. NARAB would be backed by federal authority and serve as a central clearinghouse for producers who wish to do business in multiple states.

In February 2000, the NAIC adopted the Producer Licensing Model Act (#218) to help the states comply with the GLBA’s reciprocity provisions. Subsequently, the NAIC membership determined a majority of jurisdictions had met the non-resident producer licensing reciprocity requirements under the GLBA and, as a result, NARAB was never created. However, continued concern over the lack of reciprocity among all states has prompted the U.S. Congress to seek a further solution.

A modified version of the national licensing proposal, the National Association of Registered Agents and Brokers Reform Act (or NARAB II, as it is being commonly called), is again pending before Congress. NARAB II would streamline the non-resident producer licensing process but preserve the states’ ability to protect consumers—it does not create a federal regulator for insurance and the states would retain...
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their regulatory authority over consumer protection, market conduct and unfair trade practices. The states also would retain their rights over resident licensing, as well as supervision, discipline and the establishment of licensing fees for insurance producers.

**FBIIC**

The important role of the U.S. Treasury Department’s Financial and Banking Information Infrastructure Committee (FBIIC) is little known to the public. It does, however, serve a crucial role in assisting with disaster response and recovery. FBIIC is an interagency organization charted in 2001 under the President’s Working Group on Financial Markets. The FBIIC is charged with coordinating efforts across the financial services sector to improve the security and reliability of the critical infrastructure necessary for financial markets to function. Members of the FBIIC include representatives of the Federal Reserve Board, the Treasury Department, the U.S. Securities and Exchange Commission and the NAIC.

On a day-to-day basis, the FBIIC is involved in activities such as identifying critical infrastructure assets, documenting their locations and figuring out their potential vulnerabilities, and then prioritizing each item’s importance to the U.S. financial system. The FBIIC also establishes secure communications capability among the various financial regulators and develops protocols for communicating during an emergency.

The NAIC is engaged directly with the FBIIC on cybersecurity and natural disaster planning issues. In March 2014, Brian Peretti, acting director at the U.S. Treasury Department’s Office of Critical Infrastructure, presented at the CIPR “Insuring Cyber Liability Risk” event, which took place at the Spring National Meeting. Mr. Peretti, who leads the efforts of the FBIIC, provided an in-depth overview of the cyber liability landscape. Please see page 22 for an overview of his presentation.

**DoS / DDoS**

A denial-of-service (DoS) attack is an attempt by attackers to prevent legitimate users of a service from using that service. The most common type of DoS attack occurs when an attacker “floods” a computer network with traffic. This sudden increase in traffic overwhelms the target system, preventing legitimate users from accessing information and services, and essentially leading to system paralysis and a DoS for authorized users.

A distributed denial-of-service (DDoS) is a type of attack where a network of computers are used to target a single system or website. An attacker may also use your computer to attack another computer. The attack is “distributed” because the attacker is using multiple computers, including yours, to launch the DoS attack.

Perpetrators of these attacks typically target websites or services hosted on high-profile Web servers such as banks and credit card payment gateways. Several major financial services firms have recently announced they have been victims of a DDoS attack, including JP Morgan chase, Wells Fargo, Bank of America and Citigroup.

These attacks are growing more common and can result in significant loss of time and money for many organizations. A recent article published in the Wall Street Journal, “A Call to Arms for Banks,” described the growing push by regulators for financial services firms to better arm themselves and the financial system against cyber attacks.

**Summary**

As you can see, there are many new and existing insurance regulatory acronyms to be learned. The CIPR will continue to keep you updated on the latest regulatory acronyms, as well as their developments and implications.

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**About the Author**

Shanique (Nikki) Hall is the manager of the NAIC’s Center for Insurance Policy and Research. She joined the NAIC in 2000 and currently oversees the research, production and editorial aspects of the CIPR Newsletter and website, among other responsibilities. Ms. Hall has more than 20 years of capital markets and insurance expertise and has authored numerous articles on insurance regulatory issues. She began her career at J.P. Morgan Securities in the Global Economic Research Division where she worked closely with the chief economist to publish research on the principal forces shaping the economy and financial markets. Ms. Hall has a bachelor’s degree in economics and an MBA in financial services. She also studied abroad at the London School of Economics.
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