NAIC National Association of Insurance Commissioners & The Center for Insurance Policy and Research

CIPR newsletter

Emerging Regulatory Issues in 2014

By Adam Hamm, NAIC President and North Dakota Insurance Commissioner

It is with great pleasure and honor I accept the challenge to serve as President of the NAIC for 2014. I recognize I have a daunting task before me. However, I do not face these challenges alone. The NAIC members have elected a solid officer group with sound leadership and collaboration skills. I plan to lean heavily on the officers and all NAIC members to do their part to support consumers and the state-based insurance regulatory system. Working together we can achieve remarkable results.

The purpose of this article is to share my views on some of the key challenges and initiatives we will be working on in 2014 and beyond. Every segment of the insurance industry is facing challenges in this modern world. The low interest rate environment presents concerns for all sectors, but is most noticed in the life insurance sector. Property and casualty insurers are addressing technology changes and the approaching sunset of the Terrorism Risk Insurance Act (TRIA). Health insurers have dominated the front pages of our newspapers as the federal exchange platforms failed to perform up to expectations. On Jan. 1, the choices made in the exchanges became effective. Time will tell if there are other service glitches that arise as the Affordable Care Act provisions are implemented.

◆ Principle-Based Reserving Implementation and Life Insurer-Owned Captives

An important regulatory modernization issue relates to a change to the regulatory framework for calculating life insurance reserves. Over the past several years there has been much discussion about how the current rule-based reserve requirements create redundant reserves for some products and inadequate reserves for others. The generally agreed-upon solution is to move from a rule-based approach to a principle-based approach. The Principle-Based Reserving (PBR) Implementation (EX) Task Force was created to develop a plan for implementation of PBR concepts. The Task Force adopted the PBR Implementation Plan in July 2013. I would like to provide an update on progress made, discuss future plans and cover a related issue—life insurer-owned captives.

The PBR Implementation Plan provides a framework for implementation of PBR concepts and is a working document to be modified as necessary to meet the challenges ahead. The plan calls for significant changes to the Standard Valuation Law (SVL) and Standard Non-Forfeiture Law (SNFL). States have begun the legislative adoption process with respect to both laws. To date, nine states have adopted both laws. To help smooth the path toward eventual adoption of PBR, the Task Force has made some significant steps toward strengthening the framework.

The Task Force has assigned PBR-related charges to a number of existing technical groups including the Life Actuarial (A) Task Force, Examination Oversight (E) Task Force, Financial Analysis Handbook (E) Working Group, Financial Condition Examiners Handbook (E) Technical Group, Financial Analysis Research Development (E) Working Group, Blanks (E) Working Group and NAIC/AICPA (E) Working Group. In addition, a Valuation Analysis (E) Working Group was created. This Working Group will operate in a manner similar to the Financial Analysis (E) Working Group. It will work collaboratively with financial regulators by responding to issues and questions, and recommending PBR requirements and interpretations. It will provide peer review of PBR reserves and ensure quality PBR reviews in all states. The Working Group members will be assigned after the PBR Review (EX) Working Group has recommended charges and developed operating procedures for the Valuation Analysis (E) Working Group. Hopefully these activities will provide a greater level of comfort for all regulators in regard to reserves established using a PBR approach.

Working with state legislatures on PBR implementation issues is critical. Without them the project will fail. Recognizing PBR concepts are complicated and there is some political resistance to them, a legislative information package is being created. So far, a PBR Legislative Brief is complete, as is an Educational Brief. The briefs have been distributed to all state insurance regulators. Work is under way to develop a PBR Education Plan for state insurance regulators and their staff. In addition, a PBR Education Webinar for regulators and staff was conducted Oct. 9, 2013. It was taped and is available to anyone who registers with the NAIC Education and Training Department.[1]

The PBR Implementation (EX) Task Force concluded its work at the end of 2013. A few remaining tasks were assigned to a newly created PBR Review (EX) Working Group. The Working Group is responsible for coordinating tasks and building a structure to support the development of financial analysis, examination and actuarial review procedures. The Working Group will identify the data, data elements and other reporting needs to facilitate actuarial reviews, financial analysis and public transparency, including developing industry benchmark data around the mandatory experience data reporting collected via a statistical agent. The Working Group assigned a PBR Review Procedures (EX) Subgroup to

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[1] www.naic.org/education_home.htm

develop procedures for risk-focused examinations and analysis under a PBR framework, to draft charges and operating procedures for the Valuation Analysis (E) Working Group, and to develop review tools and to test the tools and data for usefulness and accuracy. The PBR Review (EX) Working Group assigned a PBR Blanks Reporting (EX) Subgroup that will recommend changes to the blanks and blanks instructions to support the PBR framework as well as requirements around the governance of the actuarial function regarding the board and senior management.

Regulating in a principle-based environment is different than a rule-based environment. There will be much greater reliance on the opinions of actuaries and the need for much more transparent and granular information to support the assumptions relied upon by the actuary. This calls for the creation of a statistical agent along with development of the necessary regulatory framework for its operation. The statistical agent will be charged with the collection of company experience data. In 2014 we will need to develop evaluation criteria and a process for the selection of one or more statistical agents to collect industry experience data on behalf of all the states. We must also develop a framework for allocating statistical agent and professional actuarial expenses across the insurance industry. It is clear the states will need enhanced actuarial staff to work within a PBR framework. Some of the new actuaries will need to have financial modeling skills. Decisions will need to be made whether to add these at the state level or to centralize the expertise by adding them to the NAIC staff. Decisions will also be needed regarding the role of the NAIC in managing the statistical agent process on behalf of the states so experience data can be collected on a national basis. Once some of these decisions are made, recommendations for changes to the Accreditation Program will be necessary to reflect the new PBR framework.

In recent years, perhaps as a reaction to rule-based life insurance reserving standards, life insurers have been interested in forming captive reinsurers to assume some insurance risks. Traditionally, a captive was an insurance company created and wholly owned by one or more non-insurance companies to insure the risks of its owner or owners. In essence it was a structured form of self-insurance. Once established, a captive is subject to different state regulatory requirements than traditional insurers.

More recently, many life insurers have used captives as a means to "finance" the purported "redundant" reserves created by XXX and AXXX reserves required by regulators in the rule-based environment. The financing effect occurs as a result of different regulatory requirements for captives. It is important to note the differences were designed to accommodate traditional self-insurance captive transactions, and it was never contemplated life insurers would use captives to reinsure loss reserves. This use of captives by life insurers has been approved by various regulators, as they have agreed such XXX and AXXX reserves are in many cases overly conservative. As these transactions have become more common, the ceding insurance regulator and the captive regulator have generally required the insurer to determine the economic reserves (or actual expected losses) associated with the obligations and to obtain a third-party actuarial review to ascertain such value. These economic reserves, plus a small margin for adverse development, must be secured by traditional high-quality assets held by the ceding company. The remaining "redundant" reserves are required to be secured by a letter of credit that benefits the ceding company. This alternative asset allowed for the captive results in capital relief for the life insurer.

Life insurers are motivated to participate in these captive reinsurance transactions to obtain surplus relief. Traditional life insurers are subject to statutory accounting requirements which provide conservative reserves and limit the types of assets they can count as admitted assets. A letter of credit is not an admitted asset under statutory accounting. However, some states allow captive insurers to count a letter of credit as an admitted asset. Thus, a life insurer can improve its balance sheet and preserve scarce capital resources by transferring the XXX and AXXX reserves to their captive.

This flexibility allowed by some regulators is a cause of concern for other regulators. A life insurer using a captive to reinsure XXX and AXXX reserves may have a competitive advantage over other insurers not using a captive reinsurer. Regulators attempt to ensure all licensed entities operate in a consistent and fair competitive environment. Conservatism in reserves and asset restrictions are important components of solvency regulation for traditional insurers. Insurance regulators need to ensure that policyholders are appropriately protected when the reserves are transferred to captives that are subject to these different regulatory requirements, such as differing admissible asset and capital requirements. These differences make sense for traditional captives that are insuring the risks of their owners. However, they may not be appropriate for traditional insurance risks accepted by insurers and then transferred to a captive reinsurer. Additionally, each state has implemented its own unique structure for captives. As a result of the diversity of the approach, some insurers may have advantages over others.

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When the NAIC members adopted revisions to the *Valuation Manual* to provide a principle-based approach for valuing life insurance reserves, the motion included a commitment to address issues with captive use by life insurers. Regulators generally agreed under a principle-based approach, rather than using captives or other special purpose vehicles, concerns with the level of reserves should be addressed within the traditional insurance solvency system, even if it means carving out a temporary niche to address an immediate problem. It is my pledge to follow through with this recommendation. Regulators need to work together to arrive at a common solution to make sure there is a level playing field for all life insurers. Changes made to implement PBR should minimize the need for life insurer-owned captive arrangements.

◆ IMPLEMENTATION OF THE PATIENT PROTECTION AND AFFORDABLE CARE ACT

Whether you like to call it "Obamacare" or the Patient Protection and Affordable Care Act (PPACA) or just the Affordable Care Act (ACA), there is no question changes to the delivery of health insurance have been and will continue to be front and center for health insurers, health care providers, the Obama Administration and for state insurance regulators.

The reforms adopted as part of the ACA are to be phased in over four years. The law recognizes the credibility and technical expertise of insurance regulators by mentioning the NAIC a number of times. Congress specifically assigned the NAIC a number of critical responsibilities, such as development of the medical loss ratio (MLR) formula, interstate sales rules, consumer information, and a consultative role on market reforms, health insurance exchanges, risk-sharing mechanisms, and rate review standards. In all, 13 categories were identified requiring NAIC involvement, and all have been addressed in an open, proactive fashion by 15 different NAIC committees, working groups and subgroups. While some provisions took effect earlier, the most wide-sweeping reforms took effect on Jan. 1, 2014, with the implementation of market reforms, subsidies and the individual mandate. Web-based shopping portals known as marketplaces (exchanges), along with agents and brokers, are the central mechanism to help individuals and small businesses purchase health insurance coverage and receive subsidies. On Oct. 1, 2013, the online marketplaces, operated by the federal government or the state, opened to consumers to begin the enrollment process and choose a Qualified Health Plan (QHP) that best meets their needs.

While the ACA greatly expands federal involvement in health insurance standards and oversight, states will continue to regulate the health insurance industry. The federal law does not eliminate state regulatory authority. All products sold to consumers, whether through or outside an exchange, will still have to be filed with the state and comply with existing state insurance laws and regulations to be included on an exchange. Under the ACA, states have the option of establishing their own exchange or participating in a federal partnership model. States that do not choose either of these options shall have a federally facilitated exchange implemented for them. At last count, excluding the territories, 17 jurisdictions implemented a state-based marketplace, seven opted for a partnership marketplace and 27 have a federally facilitated exchange.

While much has been accomplished since the ACA was enacted, 2014 will be a busy year for those working on health insurance reform. Work is under way on a number of topics, including: work on model regulations for the individual and small-group market; updates to the FAQs; assistance to state regulators with actuarial issues related to the ACA; actuarial recommendations for the long-term care insurance bulletin and model act; development of a white paper addressing potential issues related to self-insurance using stop loss coverage; review of rate and affordability issues in the long-term care insurance market; development of a white paper on navigator, producer and assister oversight; commencing work on cost and access issues; developing a paper on innovative state programs; and work on collection, transmission and reporting of complaints, company licensing and enforcement actions required for issuer oversight.

I am proud of how state insurance regulators have put aside political differences and worked in constructive ways to make sure consumers have the information they need to make informed choices. While much work remains, keeping the complexity of the law in mind and doing what is best for the consumer will lead us to the best possible outcomes.

◆ FEDERAL RELATIONSHIPS AND OTHER FEDERAL ISSUES

As the various state insurance markets have evolved over time, there has been increasing activity dealing with various federal agencies. The Financial Services Modernization Act of 1999, more commonly known as the Gramm-Leach-Bliley Act, introduced the concept of functional regulation, which requires insurance, banking and securities regulators to coordinate efforts in areas where there is overlapping regulatory authority. The enactment set off a series of collaborative meetings in 2000 between various regulators that continue to this day. Currently state insurance regulators have regular interactions with the Federal Reserve Board (the Fed), the Office of the Comptroller of the Currency (OCC),

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the Federal Deposit Insurance Corporation (FDIC), the Treasury Department, the Department of Homeland Security (DHS), the Federal Emergency Management Agency (FEMA), the National Flood Insurance Program (NFIP), the Federal Trade Commission (FTC), the Office of the United States Trade Representative (USTR), the Federal Housing Finance Agency (FHFA), the Federal Crop Insurance Corporation (FCIC), the Centers for Medicare & Medicaid Services (CMS), the Department of Health and Human Services (HHS), the Department of Transportation (DOT) and the Department of Veterans Affairs (VA).

With the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), several new entities came to the Capitol, including the Federal Insurance Office (FIO). The FIO has monitoring responsibilities over all lines of insurance except health, long-term care and crop. The FIO is not a regulator. Its director serves as a non-voting member of another new entrant—the Financial Stability Oversight Council (FSOC). Together with the FSOC, the FIO plays a role in any discussions concerning insurers and systemic risk. State insurance regulators are actively involved with FIO and the FSOC with Director John M. Huff serving as the insurance regulatory representative on the FSOC. The FSOC is wrestling with the difficult task of measuring and guarding against systemic risk to the U.S. economy. To achieve that end, the FSOC will need to figure out how best to implement tools to provide greater transparency regarding financial transactions to uncover counterparty risk and measure its impact on the economy. Insurers do not generally create systemic risk; however, they can become victims of it when investing in financial products where risk is hidden. State insurance regulators need to work with the FSOC to make sure insurers do not fall victim to risk from opaque financial products.

The FIO also plays a role internationally. It is a member of the International Association of Insurance Supervisors (IAIS) and its executive committee and, along with the NAIC and state regulators, has been engaged in ongoing discussions with the European Union (EU) concerning the EU's implementation of Solvency II. The FIO has authority to assist the Secretary of the Treasury in negotiating "covered agreements" concerning insurance, but has only limited authority to preempt state law through such agreements. The FIO also assists the Secretary of the Treasury in administering the Terrorism Risk Insurance Program.

One of the key issues for the property and casualty insurance industry is the possibility the Terrorism Risk Insurance Act (TRIA) will not be renewed when its sunset provision occurs on Dec. 31, 2014. Insurers, insurer trades, lenders, business leaders and regulators have been working toward a common goal of securing a timely, long-term renewal of the act.

TRIA was signed into law in November 2002 in the aftermath of the 9/11 terrorist attacks to provide a federal shared loss program for incurred losses resulting from certain acts of terrorism. Its purpose is to protect American businesses by minimizing market disruptions and ensuring the widespread availability and affordability of property and casualty insurance for terrorism risks. TRIA has subsequently been reauthorized twice by Congress in 2005 and 2007, and is currently set to expire in December 2014. State insurance regulators and the NAIC have supported TRIA since its inception and its subsequent reauthorizations.

There was optimism last fall an early renewal could be accomplished; however, congressional concern the program was an entitlement resulted in disappointment. The key issue for insurers surrounds January and subsequent policy renewals. Annual policies issued with effective dates on or after Jan. 2, 2014, have expiration dates extending into 2015, leaving the business with a coverage gap. This coverage gap is a concern for American businesses which now have uncertainty about what might happen with their coverage. Insurers have added contingency language to insurance contracts to address the possibility the program might sunset. Mortgage lenders have been reluctant to continue with major construction projects in light of the uncertainties.

In the absence of private market innovations and solutions, sustaining a viable private market for terrorism insurance depends on a federal backstop. NAIC members are committed to working with Congress, the Administration, state officials, and the industry to develop a long-term plan to make terrorism insurance available and affordable.

FIO released a report on modernizing insurance regulation in December 2013. The report does not call for wholesale federal regulation, but does recommend certain changes at the state level and involvement of the federal government in certain areas. Insurance regulators are reviewing the report's recommendations to determine next steps, if any. Many of the recommendations track ongoing efforts by the states to modernize insurance regulation. Others suggest new and occasionally novel concepts requiring further study.

Because the role of the FIO both domestically and internationally impacts ongoing work of state regulators and the NAIC, coordination and cooperation is crucial. State insur-

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ance regulators need to be wary of the FIO assumption that uniformity is always good. There are many circumstances where uniformity is not necessary or even beneficial. It is the diversity of the state insurance regulatory framework that is its strength. It is my desire to keep state insurance regulators actively engaged with our federal regulatory counterparts and to work with other non-regulatory federal agencies, such as the Treasury and FIO, collaboratively whenever possible. However, we need to remind our federal counterparts frequently about the strengths of the state regulatory system and its successful track record of overseeing the insurance industry in the most stressful economic circumstances.

Another federal creation of Dodd-Frank was the Consumer Financial Protection Bureau (CFPB). The CFPB touches insurance regulation when it issues guidance affecting title insurance and property insurance. State insurance regulators will need to work closely with the CFPB to protect consumers while respecting each other's regulatory authority.

One of the good things that happened with Gramm-Leach-Bliley and Dodd-Frank was affirmation in both acts that the McCarran-Ferguson Act remains the law of the land and reserves for states the right to regulate and tax the business of insurance. We may need to remind the federal agencies of the congressional affirmation from time to time as we work collaboratively with them on a number of important issues.

◆ GROUP SUPERVISION

The U.S. approach to group supervision is generally conducted on an indirect basis, with a primary objective of policyholder protection but for which there is indirect authority over the risks of the group through broad-based authority over the insurer. This approach differs from the consolidated supervision approach, which centers on direct authority over the entire business enterprise, which is an approach followed by some but not most international supervisors.

In recent years the NAIC Solvency Modernization Initiative has led to substantive changes regarding how insurance groups will be monitored and regulated in the coming years. Among the changes are amendments to the NAIC *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450). The model regulation includes a new Form F—Enterprise Risk Report and a more explicit statutory authority provision regarding participation in supervisory colleges. The Enterprise Risk Report is important because it requires management of the group to identify and consider potential contagion risk exposures to the insurance business. The information will be used primarily by the lead-state regulator of the group in their annual assessment of the financial condition of the group. I believe these changes will position state insurance regulators to interact with regulatory counterparts from other nations in a more structured way. It should be noted the information flowing from the Form F filings will be useful to regulators in measuring potential systemic risks from non-insurance operations within the group. This information might also be useful to our FSOC member for measuring systemic risk more broadly.

Supervisory colleges function as the core of group supervision for large international insurers, as they allow the relevant regulators to discuss the insurance group, including its financial position, as a whole. Similar types of discussions have been occurring among U.S. regulators for decades through less formal events. In 2012, insurance departments began organizing supervisory colleges for international insurance groups and participating in colleges hosted by international regulatory bodies.

Another modernization occurred when, in September 2012, the NAIC adopted the *Risk Management and Own Risk and Solvency Assessment Model Act* (#505). The Own Risk and Solvency Assessment (ORSA) is intended to provide regulators the authority to collect annual reports on the risk management and capital requirements of large and medium-size groups. State insurance regulators have conducted two ORSA pilot programs to allow regulators and the industry to learn from each other and therefore set expectations for when these reports are required in 2015. Another ORSA pilot is expected to be held in 2014. I am encouraged by the early results. While some insurers are more willing to share information than others, overall the process seems to be improving the element of understanding between insurers and insurance regulators.

Insurance departments continue their collective efforts to coordinate a wide variety of financial surveillance activities, including holding company financial analysis, coordinated reviews regarding acquisitions or mergers, intercompany transactions, and on-site financial examinations. This important work will continue during the coming months and years.

◆ INTERNATIONAL ISSUES AND RELATIONSHIPS

The world is clearly becoming a smaller place. Modern technology and travel options have gradually changed how we operate. Insurance markets have become increasingly global, yet remain surprisingly local in many regards. Many major multinational insurance companies have expanded their op-

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erations in different jurisdictions, requiring regulators throughout the world to work together to enhance cooperation and collaboration to help ensure effective and efficient supervision and promote stable markets. State insurance regulators, working through the NAIC, have been active internationally for decades and were instrumental in founding the International Association of Insurance Supervisors (IAIS).

Today, state insurance regulators work collaboratively with their regulatory counterparts from other jurisdictions around the world to develop and promote best practices for supervising multinational insurers, conduct international supervisory colleges, and assist emerging nations as their local insurance markets develop. Yet we remain mindful most U.S. insurers are not multinational and may not even be operating in more than a handful of states. There are roughly 7,600 insurers operating in the U.S. with only a few of them operating in multiple countries. The challenge for insurance regulators is to achieve a balance that encourages global market development, while protecting consumers and the local interests of the small and mid-size insurers. This is not an easy task.

State insurance regulators have to interact with several international organizations in much the same way as they do the various federal agencies. The Financial Stability Board (FSB) was established to coordinate at the international level the work of national financial supervisors and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It is sponsored by the G20 countries with a broad charge to promote financial stability throughout the world. Its work is similar to the work of the FSOC in the U.S.

On July 18, 2013, the FSB announced a list of multinational insurance groups it considers to be global systemically important insurers (G-SIIs). This means if they were to become insolvent and fail in a disorderly manner there could be a negative impact on the stability of the global financial system. The FSB has identified nine insurers, including three based in the U.S. It is important to note the action taken by the FSB is advisory only and is non-binding. State insurance regulators and the NAIC have been engaged through the IAIS Executive and Financial Stability committees in this work, and domestic state regulators have been involved on a company-by-company basis.

The G-SII list will be determined by the FSB on an annual basis, based on information provided by the IAIS. Any potential G-SII determinations with respect to reinsurers have been deferred by the FSB until 2015, pending further analysis. The FSB and IAIS are also developing a package of measures that will be applied to G-SIIs, including capital buffers, systemic risk management plans, crisis management plans, and resolution plans. It is imperative for state insurance regulators to stay on top of these developments, as the FSB tends to be bank-centric in its thinking. State insurance regulators need to monitor FSB and IAIS activities in this area to ensure the needs of U.S. insurers and consumers are not ignored.

In the U.S. the FSOC is authorized to address systemic risk and has its own process for evaluating and designating domestic systemically important insurers. So far, the FSOC has designated two of the three U.S.-based G-SII-listed insurers as systemically important domestically, and the third is under review. The FSOC statutory and regulatory process makes no reference to the FSB or G-SIIs, so it is not clear how the FSOC could consider a G-SII unless that firm would otherwise be considered a domestic systemically important financial institution (SIFI). State insurance regulators must work closely with the FSB, the IAIS and the FSOC to avoid conflicting and redundant regulatory requirements that hinder business rather than promoting open markets and competition.

Insurance regulation in some other nations is approached from the group rather than the entity level as it is here in the U.S. Other nations also tend to have consolidated regulators covering insurance, banking and securities. As a result, it is not surprising the FSB is pushing the IAIS to adopt international insurance group capital standards to apply to G-SIIs. The IAIS plans to develop backstop capital requirements (BCRs) in 2014 which will eventually serve as a basis for work on higher loss absorbency (HLA) capital measures for G-SIIs.

In addition, the IAIS has provided the FSB with a work plan to develop a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs) called the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). This work will include development of a risk-based global insurance capital standard (ICS) by 2016. Full implementation will begin in 2019 after two years of testing and refinement with supervisors and IAIGs.

State insurance regulators are engaged in the IAIS to develop group capital standards, but many concerns remain. For example, state regulators believe there are stabilizing benefits to retaining some diversity in regulatory approaches, even if greater efficiencies can be achieved. An over-reliance on a single capital standard could actually increase systemic risk. The risks inherent in insurance products, even for the

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same business line, can be very different jurisdiction to jurisdiction. A single risk charge for that business line may well lead to incorrect assessments of the relative capital strength of IAIGs. The track record in the banking sector of a reliance on capital standards did not prevent a system-wide banking collapse during the recent financial crisis. The business model for insurance is significantly different than the business model for banks. The business models and risk management approaches among insurers are unique. In addition, there remain major differences among jurisdictions in accounting systems and approaches to valuation of assets and liabilities, as well as differences in regulatory objectives.

While U.S. insurance regulators do not subscribe to the view a single uniform ICS is the perfect solution to achieving more effective regulation or greater financial stability, state insurance regulators support the need to perform capital analysis as part of coordinated solvency oversight and recognize insurance regulators in emerging markets are calling for basic international capital standards or benchmarks of some kind. NAIC members are also concerned with an overreliance on a group capital calculation that assumes capital is fungible within an organization. Ultimately, whatever is implemented at the group level should be in addition to jurisdictional capital requirements. For the U.S., it will be in addition to and not a replacement for the U.S. risk-based capital (RBC) that applies at the legal-entity level.

State regulators are concerned with the expanding role of the FSB in directing the IAIS on international insurance standard-setting matters. State insurance regulators recognize the IAIS is determined to pursue the development of global insurance capital standards, including the BCR and ICS measures. The NAIC is working constructively within the IAIS process to ensure the capital proposals being developed are reasonable and would work for all jurisdictions. Insurance regulators continue to believe the IAIS objectives on capital standards are not easily achieved and will require significant resources over many years.

NAIC members also remain concerned bank-like capital standards are inappropriate for insurers and should not be adopted by insurance regulators. Finally, NAIC members are concerned if new standards are excessive or too inflexible, then they could increase costs on U.S. insurers and consumers. The new standards could potentially undermine the states' track record of effective solvency supervision and stable competitive insurance markets. All this points out how important it is for state insurance regulators to be engaged in international regulatory activities. Without our engagement, standards we find objectionable might be forced upon us.

The IAIS has been working to develop ComFrame to enhance the cross-border supervision of IAIGs. ComFrame is intended to build on the IAIS Insurance Core Principles (ICPs) and form the basis for defining best practices and evaluating their use by supervisors around the world. The ICPs are similar to NAIC model laws and regulations. Currently, the project is nearing the end of a three-year development phase before entering a four-year field-testing phase in 2014, with a target adoption date of 2018 and implementation date of 2019.

State insurance regulators and the NAIC have been engaged in the ComFrame project in the development stage, including extensive discussions on a range of challenging issues in the areas of group accounting, capital, governance, and solvency. The focus of NAIC efforts at every step has been to emphasize supervisory cooperation practices while avoiding overly prescriptive measures that would add new layers of unnecessary regulation and result in one-size-fits-all requirements for insurers who operate globally. I believe ComFrame should promote a flexible collaborative process to achieve more common outcomes, rather than impose a top-down approach to group supervision that could undermine the strengths of the state-based system.

In fall 2013, the IAIS released a revised draft of ComFrame for public consultation through Dec. 16, 2013. The new draft reformats and streamlines the framework and generally represents a significant improvement from earlier drafts. The NAIC strongly supports the goals of enhanced coordination and cooperation but remains concerned the ComFrame document should not be rigid in its guidance for supervisors or impose unwarranted new burdens on insurers simply because they operate internationally. State insurance regulators will remain engaged as ComFrame progresses.

An important international matter is how regulatory regimes treat each other. There is a tendency from other nations with a national regulator to believe everyone should operate with a national regulator. This can become an issue when other nations deal with the U.S. and Canada. The U.S. regulatory framework is entirely state-based. The Canadian system employs a national solvency regulator along with provincial regulators for market regulation. The regulatory system in the European Union calls for a determination if another jurisdiction is "equivalent." If a regulatory system is deemed "equivalent," then there is recognition of the work of the regulator in supervising the insurers within its borders. The EU believes it is inconvenient for each of the 28 EU countries to have to make an "equivalency" determination regarding each of the 56 jurisdictions making up the NAIC

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membership, yet they would be fine with us having to make a similar determination regarding the 28 EU nation states. Discussion about the fairness of this belief led to the U.S.-EU Insurance Dialogue Project.

Since January 2012, the NAIC, FIO, European Commission, and European Insurance and Occupational Pensions Authority (EIOPA) have been engaged in a joint project that builds upon a regular series of U.S.-EU discussions over the past decade to exchange views on our different approaches to solvency oversight and to explore ways to increase cooperation. In December 2012, the Steering Committee of the U.S-EU Insurance Dialogue Project issued a joint report along with a set of common objectives and initiatives to be pursued over the next five years that focus on important areas such as group supervision, international supervisory colleges, data collection and analysis, independent third-party reviews, and on-site examinations.

Many of these initiatives are already under way or under consideration within the NAIC process at one or more committees or working groups. Pennsylvania Insurance Commissioner Michael F. Consedine and NAIC CEO Sen. Ben Nelson are currently participating as the representatives of the NAIC on the Project's Steering Committee. The Steering Committee meets regularly to discuss progress on the overall project plan and ongoing work on specific issues, with priority focus on the areas of professional secrecy, group supervision, and reinsurance collateral. The Steering Committee convened a public forum on international group supervision and supervisory colleges Dec. 14 in conjunction with the 2013 NAIC Fall National Meeting in Washington, D.C. In addition, a progress report was provided at the International Insurance Relations (G) Committee meeting Dec. 15, 2013.

◆ CONCLUSION

As you can plainly see, insurance regulators are facing a number of challenges in this and the coming years. We have a very good story to tell, as our industry weathered the 2007-2008 financial crisis much better than some other financial services sectors. We need to continue our work with our federal and international colleagues to help them better understand the state-based national system of insurance regulation operating in the U.S. Where we need to modernize, we should. However, we should not blindly move toward uniformity simply to be uniform. It is the diversity of the state legislative and regulatory systems that are its strength. We cannot forget that fact. We need to move forward with constructive change where it is warranted and resist efforts to change what works well.

ABOUT THE AUTHOR

Adam Hamm was appointed Insurance Commissioner in October 2007 and was elected to a four-year term in November 2008 and again in 2012. Hamm has a strong and varied background that includes experience in public service and in the private sector.

Hamm's dedication and desire to serve the public was in part born out of his experiences seeking justice for personal crime victims as a prosecutor for the Cass County State Attorney's Office.

Hamm also worked as an attorney in private practice, advocating for North Dakota businesses and individuals. He specialized in a number of areas, including commercial litigation, administrative agency law and transportation law.

Hamm is a graduate of Sam Houston State University and earned his J.D., with distinction, from the University of North Dakota School of Law. He is a member of the State Bar Association of North Dakota, and is a member of the Governor's Task Force on Violent and Sexual Offenders.

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