

## **NFI Public Policy Summit**

Remarks of Commissioner Lindeen

*March 12, 2014*

Hello. Thank you for such a warm welcome. I'm pleased to be here to help commemorate the 10<sup>th</sup> Annual Insurance Public Policy Summit. Given all the attention Washington D.C. has recently paid to insurance regulation, this forum was well ahead of its time when it first convened in 2004, and is now more pertinent than ever. And just as Washington is starting to catch up on the issues those of us in this room have cared about for years, we are also seeing increased interest from the international community. I'd like to applaud NFI for again being ahead of the curve – this conference “Confronting New Challenges in U.S. and International Regulation” is both timely and topical.

As regulators, every decision we make – or even contemplate making – goes through a thorough vetting process. And it must. The work we do has far-reaching implications, as financial entities become more interconnected and insurance markets expand globally. The upside of our work is the reassurance we have that the insurance sector continues to reliably protect consumers, serves as a stable source employment for millions of American jobs and provides stability for the broader financial marketplace.

Conceptually, insurance supervision is simple. Regulatory functions fall under either solvency or market regulation. In practice, it's much more complicated. I know many of you follow the activities of the NAIC – from dialing into conference calls to attending our National Meetings - like our next one in Orlando at the end of the month. I think the best use of my time here today is to highlight some of the bigger issues we will be working on this year. At the start of the year, NAIC leadership convened to outline priorities for 2014, and they are - in no particular order: 1) Principle-Based Reserving, 2) the implementation of the Affordable Care Act, 3) Federal Issues and Relationships, 4) International Activities and Relationships and 5) Group Supervision.

Before getting into some of the NAIC's priorities, I want to say a brief word about the recent Federal Insurance Office report on Modernization of Insurance Regulation. Bear in mind that the Dodd-Frank Act did not task FIO with providing a broad and balanced evaluation of insurance regulation – instead it tasked FIO with identifying gaps and areas for improvement. Nevertheless, the FIO report, much like last summer's GAO report and the FSB's peer review, acknowledges that state

regulators have developed a system of oversight that satisfies the most fundamental regulatory objectives: insurance industry solvency and policyholder protection. At my Department in Montana and at insurance departments across the country, we pride ourselves on meeting that objective every day.

The FIO report contains several recommendations for near-term reform by the states as well as a few suggestions for direct Federal involvement in regulation. As you might imagine, every year state regulators, legislators, and even Governors receive suggestions on various insurance regulatory issues from federal agencies, international bodies, the consumers we protect, and the industry we regulate. All suggestions on regulatory issues deserve serious and thoughtful consideration. In this case, we are still evaluating the FIO report recommendations, but it is worth noting that we are already addressing many of the items identified in the report – state regulation is not and has never been static, and as we continue to make significant enhancements to our system. We appreciate the work that went into the report, and look forward to a continued productive dialogue with FIO as we move ahead with our efforts and priorities at the NAIC.

### **1) Principle-Based Reserving**

The first priority I'd like to cover is the innovation we are seeing in our shift to principle-based reserve, or PBR, requirements. The intent of PBR is to provide more dynamic rules that address the weaknesses of a formulaic regulatory requirement and will account for varieties and complexities of products. The PBR system gauges risks inherent in insurance products by measuring insurance, investment and reinvestment cash flows. The resulting necessary reserve is based on the degree and level of the risks assumed by the insurance company. The greater the level and number of risks undertaken by the insurance company, the greater the required reserve will be. We like to say the PBR system "right sizes" the reserve based on the underlying risks.

We created a task force and working group specifically to create the framework and oversee implementation. States have begun the legislative adoption process for the Standard Valuation Law and Standard Non-forfeiture Law, which are needed for a state to move forward. To assist state legislatures in the adoption process and the understanding of PBR, the task force developed a legislative information package, which contains a brief summary of PBR, as well as a more detailed education brief on PBR. To date, seven states have adopted both laws: Arizona, Indiana, Louisiana, Maine, New Hampshire, Rhode Island, and Tennessee.

The PBR Working Group is responsible for coordinating tasks and building the support structure for financial analysis, examination and actuarial review. They will develop changes needed to the statutory financial blank, risk-focused financial examinations, and analysis. They will develop governance requirements for board and senior management around the actuarial function under a PBR system. The working group will also identify data elements and reporting needs to facilitate actuarial review, financial analysis and public transparency, including mandatory collection of company experience data via a statistical agent, and developing industry benchmark data used to validate company assumptions used in the cash flow modeling process. We also have a number of existing task forces, working groups and technical groups working on PBR. That is a lot of work. To facilitate so many changes, we created the PBR Education Plan for state departments and hosted a webinar in October about the upcoming changes.

### *Captives*

A related issue to the PBR transition is the treatment of captives. For some time now, the NAIC has studied the various captive reinsurance transactions used by life insurers for term life insurance (XXX) and universal life with secondary guarantees (AXXX), and we are in the process of establishing consistent regulatory treatment of the transactions – as I mentioned before “right-sizing” reserve requirements. We understand that most of the industry would like to continue the use of captives in some form – the NAIC has two task forces and a committee diligently working through the issues surrounding captives and will be discussing some of them at our upcoming national meeting in Orlando.

## **2) Affordable Care Act (ACA)**

PBR and Captives are certainly not the only areas where we are implementing change – the Affordable Care Act continues to take up much of our time and energy. With 56 members and unique markets and economies around the country, we have a variety of approaches to implementing health care reform. With such diverse opinions within our ranks, the NAIC did not take a position for or against on the Affordable Care Act, but we worked hard to make sure the legislation afforded as much flexibility to the states as possible. Our activities are now focused on meeting statutory requirements and helping our members maintain stable and accessible insurance markets in our states. Not an easy job. In the areas where we do have consensus, we continue to work together. Some of the issues facing regulators – and by extension the NAIC – include: the

oversight of marketing activities by navigators, producers, assisters, and carriers; market conduct and tracking complaints; fighting fraud; and addressing issues of cost and access. We are also assisting in consumer outreach and education, including developing and distributing consumer alerts on specific issues surrounding the ACA.

I'm pleased that we have a good story to tell in Montana, and I am very proud of the work that has been done in my home state. However, the rollout has not been smooth across the country. The NAIC continues to support all of our members – regardless of if they have a state-based exchange or a partnership or federally-run marketplace.

While health reform has probably received the most media attention of any insurance issue in the past couple of years, it is only one of many projects we are advancing at the NAIC.

### **3) Federal Issues and Relationships**

The ACA is a clear example of federal policy impacting local insurance markets. It is more critical than ever that we remain engaged with Congress and federal agencies to ensure state insurance departments maintain their authority, and that federal policy decisions don't adversely impact state insurance markets across the country.

Another example is the Dodd-Frank Wall Street Reform and Consumer Protection Act – or Dodd-Frank – which was passed just a few months after health reform. One overarching goal at the core of reforms within the law is to identify and limit systemic risk in the financial sectors. While Dodd-Frank largely rejected significant changes in insurance regulation and instead focused on oversight of other financial sectors, there are elements of the law that impact insurers and insurance supervision – particularly those areas where insurance intersects with banking and capital markets.

#### **FSOC**

A primary goal of Dodd-Frank was addressing companies that could threaten the financial system and the economy. To that end, it created the Financial Stability Oversight Council – the FSOC, to identify such companies. The FSOC's designation of AIG and Prudential as systemically important nonbank financial institutions, or nonbank SIFIs, has caused concern among state insurance regulators. The designation of AIG in particular was not unexpected given the company's role in the economic crisis. But the public justification provided by those that supported systemic designation

suggests a fundamental misunderstanding of the insurance business, state authorities, and the tools regulators have at their disposal. It was especially disconcerting - at least with regard to Prudential's designation - that those that know the insurance sector the best, Director Huff from Missouri who serves as the insurance regulator representative on the council, and Roy Woodall, the voting independent member with insurance expertise, both dissented from the Council's designation of the company. The NAIC continues to believe that traditional insurance activities do not pose a systemic threat to the financial system, and we have encouraged FSOC to focus on highly leveraged, thinly capitalized, or unregulated activities of non-banks as it exercises its authority.

Nevertheless, a systemic designation is now a reality for the insurance sector, and the standards that will be applied to such firms will be influenced by domestic and international developments. As such, insurance regulators have an obligation to weigh in on all fronts to put forward ideas and thinking that best reflect the reality of the U.S. insurance market.

We find ourselves in an environment where some in the U.S., and many around the world, increasingly seek to treat insurers like other financial sectors and take a bank regulator's approach to insurance risk. This is a flawed method, but we have to work together to ensure that the U.S. insurance industry does not fall victim to these efforts.

### **Federal Reserve**

One of the consequences of a systemic designation is that a company will be subjected to regulation by the Federal Reserve. Insurers set up as Thrift Holding Companies, previously regulated by the Office of Thrift Supervision, are also now regulated by the Federal Reserve, pursuant to Dodd-Frank. Given these and other recent developments, state regulators are engaged in frequent dialogue with our colleagues at the Fed. We continue to serve as a resource regarding insurance regulation and providing input as they exercise their new authorities. We have commented publicly on several of their recent proposed rules, and continue to emphasize that they and other Federal regulators need to take into account fundamental differences between insurance and banking.

The Treasury Department and Federal Reserve make up just a few of our many current federal engagement points. More so now than ever before, we are truly engaging the federal government, and not only on Dodd-Frank or the Affordable Care Act. In any given week, NAIC members and staff are working with dozens of federal agencies and interfacing with members of Congress, providing

expertise on conference calls, serving on committees, commenting on proposed rules and legislation, and providing testimony. We are working with agencies ranging from the Securities and Exchange Commission to the Department of Labor and Federal Housing Finance Agency on all sorts of matters that touch the insurance sector. Our increased engagement on multiple federal fronts is a positive and important development as we continue to promote our national state-based system.

## **TRIA**

For example, the NAIC is actively engaged with Congress on the reauthorization of the Terrorism Risk Insurance Act (TRIA), which expires at the end of 2014. State insurance regulators have supported TRIA since its inception and its subsequent reauthorizations.

We believe that a federal partnership with the private insurance markets provides security by minimizing market disruptions and ensuring the widespread availability and affordability of property and casualty insurance for terrorism risks. Further, it does so with minimal financial risk to the U.S. government, as the program provides a mechanism to reimburse the federal government for its expenditures. A long-term TRIA reauthorization will help to ensure economic stability through the availability of terrorism coverage for commercial policyholders, lenders, builders, and the businesses that operate in urban centers and other areas prone to a terrorist attack.

The NAIC adopted a resolution in August last year reiterating our strong support for continuation of the program. We also submitted comments to the President's Working Group on Financial Markets detailing our support for TRIA reauthorization, copies of which are available on our website.

If history is any indication of the future, I fear that Congress will wait until the last possible second to extend TRIA, causing uncertainty in the marketplace. But regardless of how slowly the wheels of Congress turn, state insurance regulators working through the NAIC will keep engaging with Congress on this important issue.

## **4) International Activities and Relationships**

Another area of focus for the NAIC in 2014 is our commitment internationally. Over the past year, the international discussion of insurance supervision has intensified and there have been several significant developments as a result.

Last summer, the Financial Stability Board determined that nine internationally active insurance groups are systemically important, which means they believe their business activities pose risks to the global financial and economic system. Several global reinsurers are also under consideration. Shortly thereafter, the FSOC, as I mentioned earlier, declared that two U.S. based insurance groups pose systemic risks, and we know additional U.S. firms remain under scrutiny as their potential risks to the financial system are being assessed. Allowing insurers to engage in activities that make them systemic is not in the interest of policyholders, and to the extent they do engage in such activities, regulators need to be collaborative and thorough in addressing the source of risk. But we do have concerns that the creation of two tiers of companies – where some insurers are deemed “safer” than others could lead to market disruptions, unfair competition or reduce market discipline. That is why the bar for designation should be high, and our goal is to wind down the activities that are deemed systemic.

When it comes to global collaboration, the forum we rely on is the International Association of Insurance Supervisors. As a founding member of the IAIS, the NAIC and state insurance commissioners remain committed to using the association as a forum for coordination and global standard-setting. We continue to enhance supervision of globally active insurance entities through better coordination, both learning from and contributing to best practices globally. Specifically, we have seen improvements in group supervision and are using enhanced tools such as supervisory colleges. We feel strongly that oversight between jurisdictions should be coordinated in a common framework that provides the necessary checks and balances for effective cross-border supervision – much like how coordinated regulation is a cornerstone of the state-based system in the U.S.

However, this framework should focus on common outcomes and not impose unnecessary costs, or create redundancies or obstacles for insurers that operate in multiple jurisdictions. As we contemplate new regulatory developments at the state, federal, or international level, we must also be mindful to balance the justification for such developments with the costs that ultimately will be borne by consumers.

A positive development at the IAIS was the recent application of Roy Woodall to be an observer. Roy is a former state insurance commissioner and someone who is highly respected in insurance circles. He has proven an invaluable resource as the insurance expert at FSOC, and we welcome his contributions to the international insurance community.

It is critical that we maintain our leadership in the IAIS, and with countries through bilateral dialogues. The U.S. leads the global insurance market in regulatory advancements and insurance premiums. We remain committed to working with its international counterparts to encourage innovation and cooperation without weakening the strong U.S. system.

These are uncharted waters that we are navigating, but let me assure you that the NAIC and its members remain committed to moving forward and achieving progress without bending to pressure to change our system.

The FSB and IAIS will certainly influence regulatory developments around the globe, but the rules applied to U.S. insurers and overseas insurers doing business here are ultimately up to U.S. regulators and policymakers, and we have no intention of abandoning legal entity capital requirements or adding new, unjustified burdens to industry and consumers. We hope to avoid being an outlier at the IAIS, but we stand on the foundation of a system that is proven to work, and is battle tested by crises both natural and man-made. It would be a mistake to undermine what works in an effort to mirror what may be popular.

## **5) Group Supervision**

That brings me to our fifth initiative for 2014 – group supervision. In recent years, the NAIC’s Solvency Modernization Initiative led to substantive changes regarding how insurance groups will be monitored and regulated. The changes have focused on positioning state regulators to effectively interact with our counterparts in a structured and meaningful way. We anticipate the data collected, in addition to providing effective insurance regulatory tools will help regulators identify potential systemic risk from non-insurance operations within the group.

At the core of our group supervision of large multinational insurers is the use of supervisory colleges. U.S. regulators have used informal, and then formalized, supervisory colleges for decades. In 2012, insurance regulators began organizing and participating in international supervisory colleges.

The NAIC is also advancing work on 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-sized groups. We have conducted two ORSA pilot programs, and anticipate a third this year. These pilots have allowed regulators and the industry to collaborate



and set expectations for the first round of reports due in 2015. Early results have been encouraging, as the process seems to be improving the understanding between regulators and companies. And that understanding, I believe, can only improve and strengthen our regulatory framework.

### **Conclusion**

While this list isn't far from exhaustive, these are the projects that the NAIC will be giving a considerable amount of time and energy, as we expect of those who regularly track our activities. We frequently consult with academics, consumer groups and industry as we advance policy at the NAIC. As always, we welcome input from all parties as we contemplate next steps on any front. Thank you for your time and attention today.