Statement

of

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to the

United States House of Representatives

Financial Services Subcommittee on Housing and Insurance

Hearing on

"The Federal Insurance Office's Report on Modernizing Insurance"

February 4, 2014

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide comments to the House Financial Services Subcommittee on Housing and Insurance on the Federal Insurance Office's regulatory modernization report.

We represent the interests and concerns of 1,400 property/casualty insurance companies serving more than 135 million auto, home and business policyholders, with more than $196 billion in premiums accounting for 50 percent of the automobile/ homeowners market and 31 percent of the commercial insurance market. We are the largest and most diverse property/casualty trade association in the country, with regional and local mutual insurance companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. More than 200,000 people are employed by NAMIC members.

Background

The Federal Insurance Office (FIO) released on December 12, 2013, its long overdue report on insurance modernization. The report, "How to Modernize and Improve the System of Insurance Regulation in the United States," includes recommendations for "near-term reform for the States" concerning safety, soundness, and capital adequacy; insurance company resolution practices; and marketplace regulation. The report also outlines recommendations for "direct Federal involvement in regulation."

The report is not overly critical of the state-based regulatory process. "In the short term, the U.S. system of insurance regulation can be modernized and improved by a combination of steps by the states and certain actions by the federal government," it asserts. However, it does include a threat that federal involvement "will be necessary … [t]o address the inefficiencies and lack of uniformity in the state regulatory system" in the event uniformity is not achieved at the state level. Specifically, the report is critical of the "uneven" progress in modernization at the state level and asserts that if "states fail to accomplish necessary modernization reforms in the near term, Congress should strongly consider direct federal involvement."

The report represents a stepping-off point for the discussion about the next steps that can be taken to improve the system of insurance regulation in the United States. In NAMIC's view, nothing in the report's recommendations comes as a great surprise. There are certain conclusions of the report that NAMIC would agree with: regulation can be too costly and often too complex, the regulation of rates should be reformed, and disaster mitigation, such as building codes, is of great importance. There are other areas that raise concerns, including the report's implicit assumption that federal involvement will automatically translate into increased regulatory efficiency and efficacy as well as its discussion of risk classification, especially in regard to credit-based insurance scoring.

Report Findings and Recommendations

In considering the need for regulatory modernization in the U.S., the report observes that the costs of regulation for insurers are comparatively high and "the absence of uniformity in the … system creates inefficiencies and burdens for consumers, insurers, and the international community." It also states that regulation would be "… much less costly, much less prone to arbitrage, and much easier to negotiate internationally for more efficient and effective oversight of the insurance sector if U.S. insurance regulation had greater uniformity and predictability." Finally, the report makes the claim that the realities of internationally active, complex financial institutions with insurance operations, as well as the experience with AIG during the recent financial crisis, "compels the conclusion that federal involvement of some kind is necessary."

The twin goals of efficiency and uniformity in U.S. insurance regulation are shared by NAMIC. However, we would caution against concluding too quickly that these goals will be served by the inclusion of the federal government into the mix. For example, it is not clear that the report puts the near-collapse of AIG in the proper context – on the one hand suggesting that the company's complexity demonstrates the need for federal involvement while on the other, correctly observing that the Federal Office of Thrift Supervision (OTS) "rarely conducted examinations of AIG Financial Product's activities." It was the OTS that held responsibility for oversight at the holding company level. In general then, the report may not have gone far enough in recognizing some of the limitations – and, indeed, the failures – of federal regulation.

The report succinctly highlights many of the unique features of the business of insurance that NAMIC has long argued set the industry apart from others in financial services. For example, the report observes that insurers typically have less leverage than banks and generally are not likely to pose a systemic risk. Additionally, the report notes that another distinguishing feature is that insurers do not typically rely on short-term funding and are not susceptible to runs or liquidity stresses.

While the report points to the increased costs of the state-based insurance regulatory system, it also acknowledges the local nature of many insurance products and the cost and complexity of setting up a federal regulatory apparatus capable of effectuating robust professional supervision for all or part of the insurance industry. Therefore, the report concludes that the proper balance is maintenance of the state-based regulatory system with federal involvement in areas where warranted. Based on a determination that in the short-run "the U.S. system of insurance regulation can be modernized and improved by a combination of steps by the states and certain actions by the federal government," the report makes a series of recommendations for 18 state-based reforms and nine areas for direct federal involvement in insurance regulation.

Below are NAMIC's views on the report's recommendations that are of greatest concern to our association and its members.

Capital Adequacy/Solvency

FIO Recommendations: (1) For material solvency oversight decisions of a discretionary nature, states should develop and implement a process that obligates the appropriate state regulator to first obtain the consent of regulators from other states in which the subject insurer operates; (2) To improve consistency of solvency oversight, states should establish an independent, third-party review mechanism for the National Association of Insurance Commissioners Financial Regulation Standards Accreditation Program.

The report notes the strength of the underlying risk-based capital (RBC) methodology and the attempt to achieve solvency oversight consistency through the National Association of Insurance Commissioners (NAIC) Financial Regulation Standards Accreditation Program. However, the report points to uneven application of the standards and stresses the importance of a uniform set of rules for accounting and capital standards. As such, the report recommends with respect to significant solvency oversight matters that regulators establish a system whereby a domestic state regulator would obtain the consent of regulators from other states in which an insurer operates before approving any deviations from solvency standards.

The report also recommends subjecting the accreditation program to independent, third-party review to bring an unbiased perspective on the uniform adoption and implementation of capital rules and other standards.

NAMIC supports the concept of uniformity of solvency regulation, but the consent recommendation has numerous practical challenges that run contrary to the other goals of modernization and efficiency. For example, it is not at all obvious how it would be more efficient to clear discretionary regulatory decisions regarding solvency with regulators from all jurisdictions in which the company in question does business. In addition, it would likely not accomplish the uniformity intended. This might be better solved with stringent identification of critical elements required for accreditation of state departments of insurance related to risk-based capital model laws and strict application of the requirement that adoption of model laws be “substantially similar.” NAMIC would welcome third-party review of the accreditation process as well as a more open, precedent-based, and documented evaluation process.

FIO Recommendation: States should develop a uniform and transparent solvency oversight regime for the transfer of risk to reinsurance captives.

The report points to the expanding use of captive reinsurance or special purpose vehicles among the life insurance industry, as well as the concerns raised by some regulators and stakeholders over the uniformity, transparency, and capital adequacy of these mechanisms. If an insurer is to receive credit against a capital or reserve requirement because of risk transferred to an insurance captive, the report insists that the rules governing the quality and quantity of assets of the captive should be uniform and the oversight sufficiently robust and transparent in order to prevent arbitrage. To achieve that goal, the FIO recommends that states develop and adopt a uniform capital

requirement for reinsurance captives, robust standards for transparency, and proper disclosure in the financial statements of the ceding insurer. In addition, it recommends the adoption of nationally consistent standards for oversight of the reinsurance captive industry as part of the NAIC accreditation program.

The use of captives to satisfy reserve requirements is found among life insurers due to the difficulties inherent in the formulaic statutory reserving system they are required to utilize. The NAIC is making efforts to revise and reform that system with a principles-based reserving system, but there will always be product innovations, and the regulatory system may struggle to maintain pace with industry practice. This is not an issue directly impacting most property/casualty insurers, but it is an issue that creates an unlevel playing field between life insurers and other financial institutions if the reserve requirements are out of synch with economic capital requirements.

FIO Recommendation: State-based solvency oversight and capital adequacy regimes should converge toward best practices and uniform standards.

The report discusses the limitations of the RBC program, citing criticism that it is an overly prescriptive, one-size-fits-all approach and fails to account for risks such as catastrophe and operational risks. As state regulators review and enhance standards, the report recommends that they integrate best practices, standards, and principles developed through international consensus.

The report notes the implementation of the Own Risk and Solvency Assessment and recommends that states develop a uniform national standard for independent contractors to assist states with the evaluation of insurer self-assessments, as well as a means to assure that state regulators adequately understand, and are accountable for, the work and findings of such contracted specialists.

While supportive of a uniform system for capital adequacy, NAMIC contends that operational risk is not actually missing from current RBC calculations but is already provided for in other RBC factors. Consequently, attempts to include a segmented factor for operational risk will require adjustment of other RBC calculations. The perceived differences in international principles for capital and the current U.S. system are often matters of explanation, not substantive differences.

FIO Recommendation: States should move forward cautiously with the implementation of principles-based reserving and condition it upon: (1) The establishment of consistent, binding guidelines to govern regulatory practices that determine whether a domestic insurer complies with accounting and solvency requirements; and (2) Attracting and retaining supervisory resources and developing uniform guidelines to monitor supervisory review of principles-based reserving.

The report details criticism of the use of the formula prescribed by the Model Standard Valuation Law for calculation of life insurance reserves, including its static and conservative assumptions, inability to accurately reflect business practices of individual

insurers, and failure to capture specific risks. The report notes the ongoing efforts of the NAIC to develop principles-based reserving (PBR) for life insurers.

The report notes that reserve requirements should properly reflect current mortality rates, the insurer's business model, and its particular risk profile, but that substantial concerns arise with the prospect of a wholesale adoption of PBR. As a result, the report recommended that states move cautiously with implementation of PBR.

As in the segment on reinsurance captives, this recommendation primarily relates to life and annuity reserving practices. The NAIC is making efforts to revise and reform that system with a principles-based reserving system, but there will always be product innovations, and the regulatory system may struggle to maintain pace with industry practice. This is not an issue directly impacting most property/casualty insurers, but it is an issue that creates an unlevel playing field between life insurers and other financial institutions if the reserve requirements are out of synch with economic capital requirements.

Credit for Reinsurance

FIO Recommendation: To afford nationally uniform treatment of reinsurers, the FIO recommends that Treasury and the United States Trade Representative (USTR) pursue a covered agreement for reinsurance collateral requirements based on the National Association of Insurance Commissioners Credit for Reinsurance Model Law and Regulation.

The report observes that non-U.S. reinsurers account for more than half of the reinsurance premium volume that is ceded by U.S.-based insurers, yet state insurance regulators do not have direct oversight over non-U.S. reinsurers. Historically, reinsurers that are not licensed, accredited, or approved by the regulator of the state have had to post qualifying collateral equal to 100 percent of the actuarially estimated reinsurance liabilities. This requirement has been an issue of significant debate. While supportive of the goal of the NAIC Credit for Reinsurance Model Law and Regulation, the report expresses jurisdictional concerns between states and between foreign countries and states, as well as concerns about over-reliance on credit reporting agencies. Given the international complexity of the issue and the possibility of inconsistent adoption of the model language by the states, the FIO believes that credit for reinsurance is a prime topic for consolidation into a covered agreement.

In enacting the Dodd-Frank Act (DFA), the FIO and the United States Trade Representative (USTR) are authorized to jointly negotiate and enter into such "covered agreements." Further, the FIO is given authority to determine if a state law or regulation is preempted by the covered agreement. The DFA requires that prior to initiating negotiations for a covered agreement Treasury and the USTR jointly consult with Congress regarding the nature of the agreement; how it will achieve the applicable purposes, policies, priorities, and objectives; and its implementation. If the FIO and the USTR initiate negotiations for a covered agreement addressing reinsurance collateral it

would be the first test of the DFA authority in this matter and would set in motion a number of new authorities and duties for the FIO.

While NAMIC recognizes the need for consistency in the treatment of international reinsurers, we have taken a cautious but neutral position on the reduction of collateral requirements for reinsurance written in the U.S. by non-U.S. reinsurers. While reinsurance does seem appropriate for treaty-based action considering the cross-jurisdictional impacts, the use of a “covered agreement” to preempt state law seems a dangerous precedent for the FIO to pursue. NAMIC will not oppose this effort for reinsurance purposes but would be very concerned if the “covered agreement” approach to insurance regulatory and legal requirements were to move beyond this limited issue.

Corporate Governance

FIO Recommendation: States should develop corporate governance principles that impose character and fitness expectations on directors and officers appropriate to the size and complexity of the insurer.

The FIO report notes that while state regulators have the authority to conduct fitness reviews of insurer directors and officers, there is no NAIC model law on the subject. This fact has been noted by international authorities in their assessment of the U.S. system of insurance regulation. The report suggests that the focus on corporate governance that has taken place since the financial crisis “should continue and become more defined.” It suggests that state regulators should adopt director and officer qualification standards that require individuals to have the expertise to assess strategies for growth and risks to the enterprise. For an insurer that exceeds size and complexity thresholds, the report recommends that state regulators adopt an approach designed to ensure that individuals serving in leadership ranks have sufficient capacity to understand and challenge an insurer’s enterprise risk management.

The standards that FIO recommends for directors and officers may be instructional but should not be required. The specific skills identified may serve a purpose on a board, but diversity on the board is also a value. Mutual insurers serving specific occupational groups or types of businesses often have directors who are part of those specific groups and possess understanding and expertise about the needs of unique customers.

Also, corporate governance in the U.S. varies from state to state and is enforced and regulated by state agencies other than departments of insurance. This varied framework and the domicile choices made by insurers are part of the business model of each insurer. Changing that framework to satisfy international demands when no specific problem in the U.S has been identified may result in unreasonable costs and unintended consequences.

Finally, insurance regulators have numerous tools to identify, assess, and correct deficiencies in corporate governance. Insurance regulators in the U.S. have broad

authority under the model regulation related to companies deemed to be in hazardous financial condition to require correction of any corporate governance deficiencies. Before suggesting significant changes to corporate governance without an identified problem we believe existing tools should be implemented and allowed to work.

Group Supervision

FIO Recommendation: (1) In the absence of direct federal authority over an insurance group holding company, states should continue to develop approaches to group supervision and address the shortcomings of solo entity supervision; (2) State regulators should build toward effective group supervision by continued attention to supervisory colleges; and (3) The FIO should engage in supervisory colleges to monitor financial stability and identify issues or gaps in the regulation of large nationally and internationally active insurers.

The report raises concerns with the ability of any single-state regulatory authority to collect information or supervise the operations of a multi-jurisdictional insurance group, such as a large, complex global insurance firm. FIO believes that for such entities a consolidated group supervisor with knowledge of an insurer's enterprise risk management and intra-company transactions would provide superior supervision. To address these concerns, the FIO recommends improvements to the state-based regulatory structure to facilitate consolidated group supervision and expanded use of supervisory colleges. The recommendations of the FIO are similar to previous recommendations by the International Monetary Fund.

While recommending the expanded use of supervisory colleges, the report asserts that "consolidated supervision for large, internationally active U.S.-based insurance firms will require continued focus and national attention." The assertion leaves open the door to proposals for increased federal regulation of large, complex insurance operations. As part of a possibly expanded government role, the FIO recommends its participation in supervisory colleges established for U.S. firms operating nationally and internationally, and for non-U.S. firms with large operations in the United States.

The question of FIO's participation in supervisory colleges was raised during the December 14, 2013, E.U.-U.S. dialogue held in conjunction with the fall NAIC meeting. Concerns were raised by participants of the dialogue about the participation of a non-regulator in the actual operation of the supervisory college. FIO's active participation in supervisory colleges, as a non-regulatory entity, could be seen as a significant expansion of the authority of the office and raises the specter of regulatory intrusion.

The NAIC addressed group supervision by adopting revisions to the Model Holding Company Act in 2010.The revisions have been enacted in 24 states and have been proposed by nine more states to date in 2014. As a result of these enactments, the group supervision process has been dramatically altered and several international supervisory colleges have already met. NAMIC supports the changes to the Holding

Company Act to improve group supervision for large groups but asserts that a proportional approach to these requirements is needed.

Guaranty Funds

FIO Recommendation: States should adopt and implement uniform policyholder recovery rules so that policyholders, irrespective of where they reside, receive the same maximum benefits from guaranty funds.

The report notes that for property/casualty claims maximum guaranty fund payouts per claim are generally set by statute between $100,000 and $500,000, with most state laws using a $300,000 cap. As a result, consumers who purchase the same coverage or product from the same company may receive a different guaranty fund benefit depending on where they reside.

The report calls on the states to harmonize recovery rules to ensure that all policyholders, irrespective of where they reside, receive the same guaranty fund protection. The FIO suggests that if states fail to achieve uniformity, federal involvement may be necessary to ensure fair treatment of all policyholders.

It is unclear whether the FIO contemplates establishment of a federal-level guaranty fund system or establishment of a federal standard administered by the state-based guaranty fund system. The NAIC model guaranty fund language includes a $500,000 coverage cap, and recovery rules vary from state to state. Consequently, several states will require revision in their guaranty fund laws to meet the FIO call for uniformity. Adoption of uniform guaranty fund protection in all states would be preferred, but it would take some time. It is not clear how long the FIO would give states to adopt the changes before "federal involvement" would be attempted. NAMIC has long argued that subjecting insurance companies to a federal resolution authority would disrupt the existing well-functioning system. Replacing the state-based guaranty fund system with a federal system would likely be much less efficient in resolving claims inherently dependent on state law.

Producer Licensing

FIO Recommendation: The National Association of Registered Agents and Brokers Reform Act of 2013 should be adopted and its implementation monitored by the FIO.

Despite decades of attention and effort, the report cites continuing inconsistencies and inefficiencies resulting from the absence of uniformity in state producer licensing. The inability to achieve sufficient uniformity, the FIO argues, warrants congressional intervention. It recommends adoption of the National Association of Registered Agents and Brokers Reform Act of 2013 (NARAB-II) (H.R.1155/S. 534) that was overwhelmingly approved by the House and is pending approval in the Senate.

NAMIC supports passage of NARAB-II as a means to enhance competition in the marketplace, which will benefit insurance consumers while maintaining state authority to regulate the market and protect consumers.

Product Approval

FIO Recommendation: State-based insurance product approval processes should be improved by securing the participation of every state in the Interstate Insurance Product Regulation Commission (IIPRC) and by expanding the products subject to approval by the IIPRC. State regulators should pursue the development of nationally standardized forms and terms, or an interstate compact, to further streamline and improve the regulation of commercial lines.

The report notes that the absence of a uniform national standard for product approval has been criticized by both insurers and consumer advocates. Insurers point to the inefficiencies in the system and lament that the lack of uniformity compromises nationwide product availability. Consumers argue that disparate state standards and processes create opportunities for regulatory arbitrage. To address these concerns, the report recommends that states take immediate action to ensure that non-participating states join the IIPRC or adopt the standards and processes as a model law or regulation. It recommends that IIPRC standards should serve as a baseline while allowing states with higher consumer protection standards to continue enforcing those higher standards. It says that state regulators from member states should prohibit insurers from opting into less restrictive non-IIPRC standards and the scope of IIPRC's product coverage should be expanded. The FIO warned that "Federal action may become necessary if the current, and long-standing, shortcomings are not improved in the near term."

NAMIC believes that swift and efficient product review and approval are necessary to promote innovation to benefit consumers. Individual states from time to time launch initiatives to streamline processes and reduce backlogs, but inconsistencies remain. However, the experience of the compact for life and other non-property/casualty lines provides grounds to question whether that approach represents the best way to proceed. Regarding commercial lines in particular, NAMIC believes that gains have been achieved as noted in the FIO report through enactment of exempt commercial policyholder statutes but that more states need to pass such laws in order to achieve potential gains in this area. NAMIC is working with the NAIC's Commercial Lines Working Group to achieve that goal.

Market Conduct Regulation

FIO Recommendation: States should reform market conduct examination and oversight practices and: (1) Require state regulators to perform market conduct examinations consistent with the NAIC Market Regulation Handbook; (2) Seek information from other regulators before issuing a request to an insurer; (3) Develop standards and protocols

for contract market conduct examiners; and (4) Develop a list of approved contract examiners based on objective qualification standards.

The report makes a number of specific recommendations to improve market conduct regulation. Persistent problems in uniformity and efficiency in market conduct regulation led NAMIC to recommend to the FIO that standards might be included in an accreditation program, similar to the successful program on the financial side. However, because of unwillingness to recognize domestic deference in market regulation, there has been little progress toward development of binding standards for regulators for market conduct surveillance. Specifically, NAMIC suggested improvements to (1) reduce or eliminate regulatory redundancies; (2) increase interstate collaboration and cooperation among regulators; (3) ensure deference to the domestic regulator in market conduct matters; (4) implement systematic procedures for adding or changing market analysis tools or procedures; and (5) increase oversight and training of, and accountability by, contract examiners.

The report agreed with NAMIC that "coordination between states and standardization of market analysis, investigations and examinations are essential to modernization." Many of the recommendations contained in the report echo the themes and recommendations of NAMIC. Specifically, the FIO recommends that states should (1) develop a requirement that market conduct regulation be performed according to the handbook; (2) implement a process whereby information relevant to the same or similar statutory and regulatory requirements first be sought from another regulator before issuing a duplicative request to the insurer; (3) adhere to a "lead state" concept for multi-state market conduct examinations; (4) develop explicit standards and protocols to govern contract examiners including cost and schedule, education, professional background, training requirements, and appropriate ethical standards regarding conflict of interest, confidentiality, privacy, and report drafting; and (5) develop a list of approved contract examiners based on an objective evaluation of expertise and training to examine specific issues or industry participants.

The problems in market regulation are long- and well-recognized by the industry and regulatory communities, and the FIO report does a good job of laying them out along with the goals to remedy the problems. What it does not include is specific concrete policy measures to achieve those goals. The listing of problems in the report could serve as an impetus for more earnest action at the NAIC to address the problems.

Rate Regulation

FIO Recommendation: States should monitor the impact of different rate regulation regimes on various markets in order to identify rate-related regulatory practices that best foster competitive markets for personal lines insurance consumers. The FIO will work with state regulators to establish pilot programs for rate regulation that seek to maximize the number of insurers offering such products.

The report acknowledges empirical studies suggesting that rate regulation creates market distortions that adversely impact the supply of insurance and harm consumers. While the report does not call for an immediate move to open rate regulation in all states for all products, it does recommend a series of pilot projects to test rate reform. The FIO encourages states pursuing enhanced competition and capacity in personal lines insurance markets to try reforms on a limited or pilot basis to test the view that the burdens of rate regulation deter competition and reduce market capacity. The FIO noted it will continue to monitor developments in the area of rate regulation and "work with state regulators to identify best practices for implementation of pilot programs, as well as best practices for monitoring the impact of any change on consumer access to insurance."

Rate modernization has been a key component of NAMIC's regulatory agenda at the federal and state levels for many years. In comments to the FIO, NAMIC stressed the importance of removing barriers that limit property/casualty insurers' ability to set prices for insurance products. NAMIC is encouraged by the report's call for rate regulation innovation and stands ready work with states, the FIO, and the NAIC to identify test markets and product lines and initiate rate regulation reduction pilot programs as swiftly as possible. NAMIC is confident that, if structured appropriately to allow the development of competition, the results of the pilot programs will be consistent with academic studies illustrating the benefits of moving toward more open rating regimes. In fact, such studies suggest that the pilot projects are probably not necessary given that the state-based system of insurance regulation has provided a laboratory for testing a variety of different approaches to rate regulation for decades. As the report acknowledges, an abundance of existing evidence suggests that strict forms of rate regulation have a number of deleterious effects on personal lines insurance markets while providing few, if any, benefits.

Risk Classification

FIO Recommendation: (1) States should develop standards for the appropriate use of data for the pricing of personal lines insurance; (2) States should extend regulatory oversight to vendors that provide insurance score products to insurers; and (3) The FIO will study and report on the manner in which personal information is used for insurance pricing and coverage purposes.

As with rate regulation, NAMIC stressed to the FIO the importance of underwriting freedom and urged regulators and policymakers to not inhibit insurers' use of underwriting variables and techniques. With the development of enhanced information systems, such as automobile telematics, it is critically important that insurers be free to continue to develop and refine underwriting tools to more accurately reflect the risk of loss in the price of the product.

FIO Director McRaith has long been skeptical of the use of credit-based insurance scores, and the report reflects his concern. The report recommends that the criteria and methodologies used by insurers be clarified to ensure they do not rely on impermissible

or discriminatory risk factors. In a bid for a federal regulatory role, the report notes that "risk classification factors may be an appropriate subject for binding, uniform federal standards, particularly to the extent that insurance scoring methodologies involve factors that implicate rights secured under federal law." In addition to regulating the factors themselves, the report calls for more extensive oversight of insurance score vendors and companies that develop their own protocols. Specifically, it was recommended that state regulators make it a priority to improve regulatory oversight of vendors, including the development of a model law that would subject insurance score vendors to licensing and examination standards.

The report reflects McRaith's desire to elevate this issue to the federal level. The FIO cautioned state regulators and lawmakers that the office would push for federal involvement if reasonable progress is not achieved in the near term. In addition, the FIO noted it will study "the appropriate boundaries of use of personal information for insurance pricing and coverage purposes" as part of its ongoing responsibility to monitor access to affordable insurance to traditionally underserved communities.

While the report describes the use of credit-based insurance scores as "controversial," in NAMIC's view the controversy has been largely resolved. Insurance scoring has been studied extensively and has consistently been found to be a valid underwriting tool. Given that the report cites published empirical research on the effects of rate regulation, it is odd that the report's discussion of insurance scoring makes no mention of the many empirical studies, such as those conducted by the Federal Trade Commission and the Texas Department of Insurance, that provide incontrovertible evidence of the relationship between credit scores and insurance risk. References to these studies are conspicuously absent from the report's discussion of insurance scoring. Of course, there will always be some who will continue to question and challenge the practice, and the FIO report reflects that. NAMIC would dispute the suggestion that increased regulatory attention and activity are warranted in this area.

There is a notable inconsistency between the report's discussion of rate regulation and its discussion of risk classification. On the one hand, the report acknowledges that risk classification and rate-setting are closely related; it implicitly recognizes that an insurer cannot develop an actuarial (i.e., risk-based) rate if it cannot accurately assess and classify risk. Yet while the report cites empirical research showing that regulation of rates tends to distort personal lines insurance markets, its suggestion that federal restrictions be imposed on certain risk classification factors does not recognize the possibility that such restrictions will have roughly the same effect as rate regulation on insurance markets.

Finally, although raising the specter of "binding, uniform federal standards" is probably meant to suggest that the FIO could recommend that Congress enact legislation restricting the use of certain risk classification variables, the report's discussion of prospective federal standards serves nevertheless as a reminder of the need to ensure that the authority of the office itself is not expanded to a include a regulatory role.

Natural Catastrophes

FIO Recommendation: States should identify, adopt, and implement best practices to mitigate losses from natural catastrophes.

Although issues related to natural catastrophes were not raised in the request for comments, NAMIC nevertheless included them in its comments based on a belief that they are of such importance that no evaluation of insurance modernization would be complete without addressing their impact and addressing better ways for stakeholders to respond. In comments to the FIO, NAMIC outlined four core principles to guide the debate:

- Market freedom and competitive pricing will lead to innovation in developing solutions to problems relating to disaster insurance and mitigation;
- Competitive pricing and risk-based underwriting are essential to developing and maintaining a viable disaster insurance market;
- Mitigation must be an indispensable aspect of any disaster risk management and insurance initiative; and
- The National Flood Insurance Program should be maintained but must be reformed.

NAMIC also stressed the importance of strong and enforceable building codes.

With respect to other natural-catastrophe-related issues, the report notes that states are engaging in a variety of new and innovative approaches. As such, the FIO recommends that adoption of national policies wait until further development and evaluation of these programs. With respect to the National Flood Insurance Program, the report notes that a more detailed response will be provided in the upcoming report required by the Biggert-Waters National Flood Insurance Reform Act of 2012.

NAMIC is pleased that the FIO highlighted this issue for special consideration. We find it encouraging that the FIO report expounds at length on the importance of building codes and recommends that states "identify, adopt, and implement best practices for construction standards, including building codes, to mitigate losses from natural catastrophes."

Conclusion – Future Focus of FIO and Congress

On the whole, NAMIC believes the current U.S. state-based insurance regulatory system is robust and well-positioned to meet the needs of the nation's insurance marketplace. This does not mean that it is perfect. There are certainly areas that need improvement and NAMIC will continue advocating for positive changes.

With the release of the report, many have been asking which actions can or should be taken by FIO and Congress in the short-term that will help ensure the best, most effective regulatory system for U.S. insurers. NAMIC believes that FIO's focus should remain firmly on the myriad actions and initiatives at the international level and special care be taken to be involved and to protect against any unintended and tangential consequences that may arise therefrom.

It is our position that cooperation and coordination internationally is a positive thing, but it should not result in abdication of regulatory authority to foreign jurisdictions or quasi-governmental bodies. Too much focus on regulatory equivalence with other nations could result in significant and costly changes in the U.S. insurance regulatory system. Our system is strong and time-tested. Many of the international insurance regulatory principles have never been implemented, and yet they are being used to measure countries and find them insufficient. If these concerns are not properly addressed, the impact on not only U.S.-based international insurers, but also on those operating only domestically could be very significant and multi-faceted.

In the international realm, we urge FIO to coordinate with state regulators and legislators to advocate for international standards that are largely consistent with sound U.S. insurance regulatory approaches; that add value for the policyholders; and that, at a minimum, do not create competitive disadvantages for U.S.-based insurers, especially U.S. mutual insurance companies. In particular, FIO should operate from the premise that attempts by foreign entities to establish regulatory hegemony over the world's insurance markets will not necessarily serve the interests of insurers and consumers in the U.S.