Testimony of the
National Association of Insurance Commissioners

Before the
Committee on Financial Services
United States House of Representatives

Regarding:
"Capital Markets Regulatory Reform: Strengthening Investor Protection, Enhancing Oversight of Private Pools of Capital, and Creating a National Insurance Office"

Tuesday, October 6, 2009

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Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today on the issue of creating a national insurance office.

My name is Therese Vaughan. I am the Chief Executive Officer of the National Association of Insurance Commissioners (NAIC). As I testified before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises last March, prior to joining the NAIC I was a Professor of Insurance and Actuarial Science at Drake University, where I focused on the management and regulation of financial institutions. I also served as the Iowa Insurance Commissioner from 1994 to 2004, and as NAIC President in 2002. I am pleased to be here today to offer the NAIC's perspectives on establishing a national insurance office.

NAIC Continues to Support Insurance Regulatory Reform

In past NAIC testimony before this Committee, we have offered the state regulatory system as the rational starting point in any effort to modernize insurance regulation. We have focused on options for reform in areas where uniformity of process and harmonization of standards are appropriate to ensure a stronger and more effective insurance regulatory scheme. We have stated our recognition that certain fundamental improvements to state-based regulation may require federal assistance, state empowerment or selective federal partnership. And we have rejected so-called "reforms" that are merely a veiled attempt at undermining state authority and substituting self-regulation or no regulation for effective oversight.

We continue to hold those views, and I hope to be able to expound on them today in the context of establishing a national insurance office.

Ensuring Equal Standing on the World Stage

Mr. Chairman, we sincerely appreciate the efforts of you and your staff, as well as those of Capital Markets Subcommittee Chairman Kanjorski and his staff, in taking serious consideration of NAIC's concerns in drafting bills introduced by Chairman Kanjorski in both the current

Congress and the previous one to create an Office of Insurance Information (OII) at the federal level. You have worked with us to address concerns raised by our members and worked to incorporate the appropriate legislative language into the OII. That language was carefully crafted to achieve specific improvements to insurance regulation, without unnecessarily preempting state laws and regulations. Consequently, a broad cross-section of the insurance sector supports the OII and we have been pleased to offer our endorsement of that approach.

The draft Federal Insurance Office (FIO) Act, based on the Administration's proposed legislation to create an Office of National Insurance (ONI), embraces the two primary goals of Chairman Kanjorski's original legislation: (1) increasing insurance knowledge and expertise at the federal level, and (2) enhancing international competitiveness for U.S. insurance companies. However, it goes further than the OII bills in terms of its use of federal preemption, and provides a greatly reduced role for state insurance regulators. Therefore, we have submitted legislative language to help bring the Administration's proposal more closely in line with Chairman Kanjorski's original Office of Insurance Information bills.

Increasing Insurance Knowledge at the Federal Level

Mr. Chairman, Ranking Member Bachus, we fully support the concept of increasing knowledge of insurance at the federal level – indeed, a core mission of the NAIC's Washington office, and its Center for Insurance Policy and Research, is to educate and inform federal policymakers and regulators. While insurance regulatory information and expertise has always been available directly from the states and collectively through the NAIC to those in Washington, a formal federal interface is necessary. Access to information and data related to insurance is critical at the federal level, particularly as Congress evaluates appropriate oversight of the financial system as a whole. The state regulatory system, which has operated effectively for over 150 years, is an experienced, willing and able partner for a new federal insurance information center.

The vast majority of insurance data and information that would be collected and disseminated by a federal insurance office, and the capacity to continue and expand its collection and dissemination, already exists at the state level and with the NAIC. States collect a tremendous amount of information from insurers, and states require much of that information to be reported uniformly to the NAIC to aggregate a national picture of the insurance market. The NAIC maintains a large compendium of financial and subject matter information on all facets of insurance. The NAIC's comprehensive collection of insurance financial information is the largest in the world. The collection and interpretation of that information, and its continual development and refinement over the years, has been of immense benefit to state regulators and insurance consumers.

The following examples demonstrate the wealth of information and analyis currently available through the NAIC:

- The NAIC's Financial Data Repository (FDR) captures every data element of the extensive and detailed statutory annual and quarterly financial statements, including close to 200,000 data elements per annual filing, in a structured format for over 4,800 insurers.

- The comprehensive nature of the data captured in FDR also allows for extensive analysis in response to unexpected developments. Immediately after the tragic events of 9/11, the NAIC provided analysis reports to identify all insurers that would be impacted, including exposures to life, health and property insurance claims. More recently, the NAIC has provided analysis of insurers' investment exposure to subprime-related issues, allowing states to target insurers of concern long before the standard analytical tools would be able to identify them.

- States can now see the exact amount of municipal securities, by individual insurer and in the aggregate, exposed to credit quality rating downgrades due to the recent bond insurance crisis. This information has allowed the states, through the NAIC, to take proactive measures to allow these securities to be considered in the issuer's credit quality rating, and allowed ratings to be assigned to issuers with no previous rating.

- The NAIC is performing analysis of industry-wide exposures in different asset types and classes, including mortgage backed securities, and drilling down to a company-by-company level to better assess the industry's exposure to the capital markets.

- The NAIC's State Producer Licensing Database, which houses licensing and demographic information on over four million insurance agents and brokers in the United States, allows consumers to verify that they are dealing with an agent or broker that is

We point out the extent of the information available through the states and the NAIC to raise a concern with the ONI/FIO proposal and the Committee's discussion draft. To the extent that the states have the relevant information, either individually or collectively through the NAIC, the national insurance office should not seek to duplicate the time, expense, or resources necessary to obtain that information. This principle was included in the OII legislation, but the critical role of the NAIC has been deleted from the current proposal. While nothing in the proposal precludes the national insurance office from being able to collect information from the NAIC, information sharing between state and federal counterparts too often has been a one way street where information may be taken from the states through the NAIC without reciprocation. Any national insurance office should be empowered specifically to engage with both the states and the NAIC, which as illustrated above, has increasingly become an integral component of the national system of state regulation. Likewise, to the extent that a national insurance office collects information beyond what the states have, the office should be able to share that information with the states, including in a coordinated way through the NAIC.

Congress is appropriately debating how best to ensure consolidated supervision of complex financial institutions, but any solution ultimately will require regulators at the state and federal level and from different functional areas to work collaboratively. State insurance regulators have too often been excluded from federal efforts and discussions to regulate the financial markets, thereby ignoring one of the principal pillars of the financial system. If a national insurance office is created at the federal level, it must leverage and engage state regulators, and bring their resources and expertise into the federal purview.

Competition Remains Critical

It is well recognized that financial markets and institutions have become more globalized. This fact is true of insurance as well as banking and securities. As markets and institutions have become more globalized, regulators and policymakers must continue their efforts to develop a regulatory system that reflects this change.

A key goal of legislation to create a national insurance office should be to maximize the competitiveness of U.S. insurers when insurance regulatory policy is discussed internationally. The states lack the Constitutional authority to bind the nation, so empowering the national insurance office in this area is an appropriate goal. However, any binding discussion at the international level should respect and reinforce the states' authority to regulate insurer solvency and protect insurance consumers, and therefore should be limited to agreements of regulatory equivalence or mutual recognition. These types of agreements serve to "level the playing field" for U.S. and non-U.S. insurers, without preempting states' ability to prescribe the specific "rules of the game" for solvency and consumer protection. The current ONI/FIO discussion draft definition of an "international insurance agreement on prudential measures" is overly broad, and could unnecessarily preempt state solvency regulation. As such, we have offered language to limit such preemption to regulatory equivalence, which is consistent with the OII proposal.

Preservation of State Solvency Regulation

The financial turmoil of the past year has generated a newfound respect for strong capital and solvency regulations. These concepts have been embedded in state regulation of insurance, and are a critical reason why insurers have weathered the financial downturn relatively better than other types of financial institutions. Our solvency system is national in scope: all fifty states are now accredited by the NAIC, utilizing the same risk-based capital and baseline solvency standards. This system undoubtedly has been stress-tested by the dramatic losses in the capital markets – insurers, after all, are among the largest institutional investors – but it also has been vindicated by its stability and the continued safety and soundness of insurance policies and products. With that in mind, we strongly believe state solvency regulation should not be subject to preemption by the ONI/FIO, and we have offered legislative language to make that explicit.

Similarly, if preemption stemming from an international agreement could jeopardize the safety and soundness of the insurance markets or ultimately harm U.S. consumers, that preemption should be stayed or prevented. This protection was embedded in the OII legislation, but is notably absent from the current ONI/FIO discussion draft. The NAIC recommends adding a stay provision, along with a requirement that the national insurance office adhere to the Administrative Procedures Act, into any final proposal.

Finally, our support for any national insurance office is predicated on the notion that the office be a tool to connect the state regulatory system with the federal regulatory system, and not be an instrument to displace or diminish state insurance regulation. The OII legislation made clear that the office would not create a supervisory role over insurance at the federal level, and we urge inclusion of identical language into any final legislation.

Conclusion

Mr. Chairman, we fully support the goal of creating a national insurance office to serve as a resource for the federal government and a conduit for the states, but we will continue to strongly oppose any efforts to use such an office as a precursor to establishing a federal insurance regulator.

The Office of Insurance Information bills in this Congress and the previous one struck the proper balance between federal preemption and retention of the current successful state insurance regulatory system, and the comments we offer today attempt to restore that balance to any final proposal considered by this Committee. We look forward to working with you on this effort, and on the many other critical issues before this Committee.

Thank you for the opportunity to testify, and I would be happy to answer your questions.