



# **NAIC – E.U. Regulatory Dialog on Insurance**

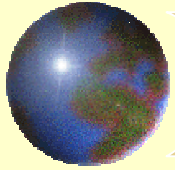


## **U.S. Insurance Regulatory Practices**

***NAIC***

**National Association of  
Insurance Commissioners**

**March 2002**

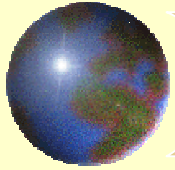


## **Presenter Information:**

Alfred Gross, Commissioner  
State Corporation Commission, Virginia

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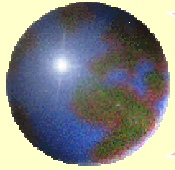
Cindy Stevenson, Special Counsel to the Director  
Dept. of Insurance, Illinois



# *Collection of Materials*

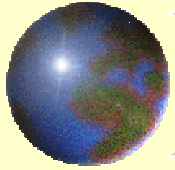
## **Index to NAIC Documents**

- **A**--Financial Regulation Standards and Accreditation Program
- **B**--Model Law on Examinations
- Chart: Financial Examination of Insurers
- **C**--Risk-Based Capital (RBC) for Insurers Model Act
- Chart: Basing Capital and Surplus Requirements on Risk; Limitation of Amount of Coverage on One Risk as a Percentage of Capital and Surplus
- **D**--Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition
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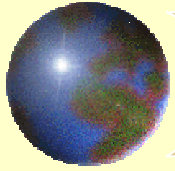
## *Collection of Materials, Cont'd*

- **M**--Model Regulation Requiring Annual Audited Financial Reports
- **N**--Insurers Rehabilitation and Liquidation Model Act
- **O**--Life and Health Insurance Guaranty Association Model Act
- Chart: Life and Health Guaranty Funds Triggering Provisions
- Chart: Life and Health Guaranty Fund Laws
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- **T**--Chart: Property and Casualty Commercial Lines Re-engineering
- **U**--Producer Licensing Model Act (PLMA)
- **Y**--Table of Contents: Accounting Practices and Procedures Manual
- **Z**--Table of Contents: NAIC Model Laws Regulations and Guidelines
- Table of Contents: NAIC's Compendium of State Laws on Insurance Topics



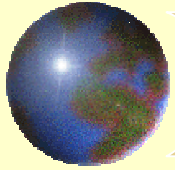
# Milestones in Insurance Regulation

- NAIC – Organized 1865
- Paul vs. Virginia Case – 1869
- U.S. vs. South-Eastern Underwriters Association Case – 1944
- McCarran-Ferguson Act – 1945
- Gramm-Leach-Bliley Act -- 1999



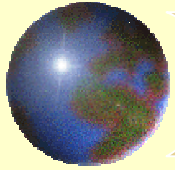
# Participants in Insurance Regulation

- Legislatures (NCOIL, NCSL)
- Insurance Commissioners
- Judiciary
- NAIC
- Trade Associations (ACLI, AIA, Alliance, NAMIC, NAAI, IIAA, CIAB)
- Consumer Groups



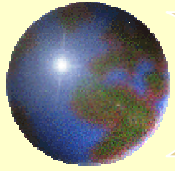
## What is the NAIC?

- Voluntary Organization of the Chief State Insurance Regulatory Officials
- 55 Members
- Three Offices: Exec., DC and SVO
- Approximately 380 employees
- \$49 Million Budget



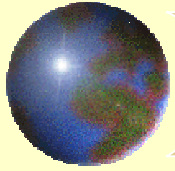
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- Federal Relations
- International Relations
- Health Policy



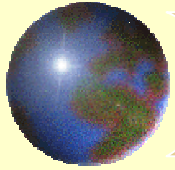
# What are the NAIC's Objectives?

- Promotion of the public interest through the regulation of insurance and the fair, just and equitable treatment of insurance consumers and claimants;
- Reliability of the insurance institution as to solvency, financial solidity and guaranty against loss; and
- Maintenance and improvement of state regulation of insurance in a responsive and efficient manner.



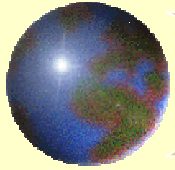
## What Does the NAIC Do?

- Provides a Forum to Discuss Common Interests;
- Facilitates Members Working Cooperatively on Regulatory Matters that Transcend Jurisdictional Boundaries;
- Monitors and Supports Committee, Subcommittee and Task Force Activity;
- Tracks non-U.S. Insurers Wanting to do Business in this Country;



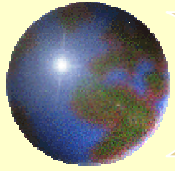
## What Does the NAIC Do?

- Collects and Maintains Financial Information from Insurers to Assist State Regulators in Their Ongoing Effort to Monitor Solvency;
- Provides Support for State Litigation in the Form of *Amicus Curiae* Briefs;
- Values Securities Held by Insurers;
- Monitors Federal Activity that Affects Insurance Regulation;
- Engages in international activities.



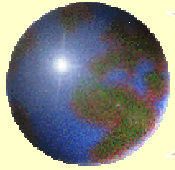
## What Does the NAIC Do?

- Assists Insurance Departments by Responding to Inquiries about Rate and Form Filings and Coordinating Their Compliance with Federal Reporting Standards;
- Supports Insurance Department Consumer Activities by Producing a Number of Consumer Guides;

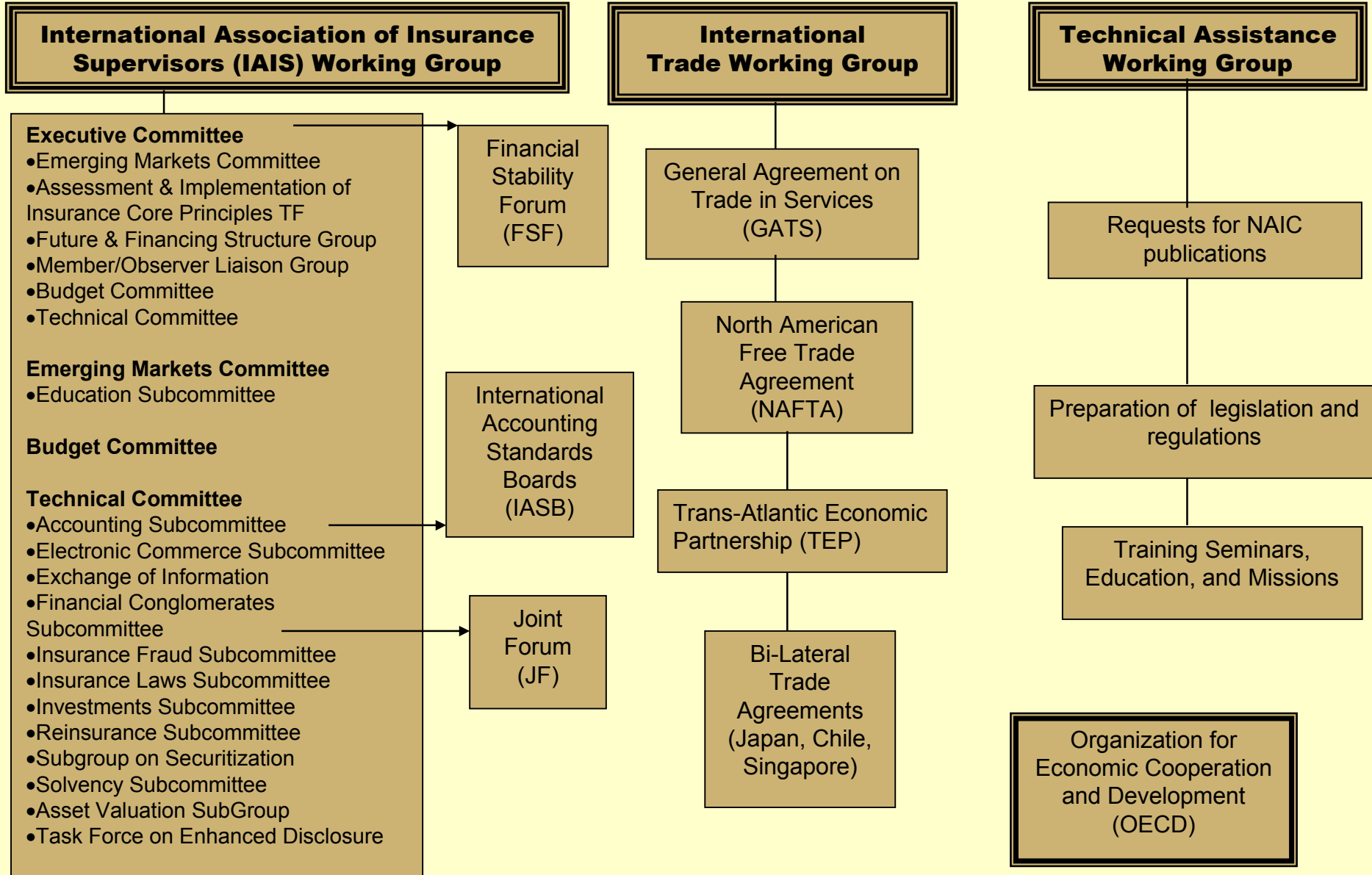


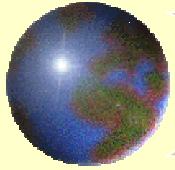
## What Does the NAIC Do?

- Prepares both Standard and Custom Statistical Reports as Well as Analysis to Support Insurance Regulators' Activities in Financial Surveillance, Rate Regulation, Actuarial and Market Analysis and Related Areas; and
- Provides Technical Expertise in Financial Regulation and Computer Audit Techniques to Insurance Regulators.



# INTERNATIONAL INSURANCE RELATIONS COMMITTEE





# State Insurance Department Organization

## Commissioner of Insurance

### Examinations

- Financial  
Routing  
Special
- Targeted
- Market Conduct
- Taxation

### Monitoring and Surveillance (Financial Analysis)

- Collection and Analysis of Data
- Audits of financial Information
- Review of nonfinancial information collected by other department units
- Classification of companies and identification of troubled companies
- Coordination of efforts and communications with departmental units and other departments

### Regulatory Actions

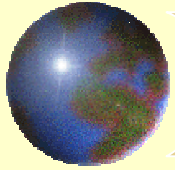
- Determining regulatory courses regarding troubled companies
- Evaluating and monitoring corrective plans
- Communicating the regulatory actions

### Other Functions

- Licensing
- Consumer affairs
- Rate and Form review
- Agents and brokers
- Legal

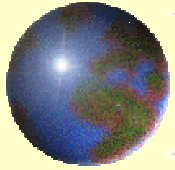


# **Overview of the NAIC Financial Services, Financial Regulation & Accreditation**



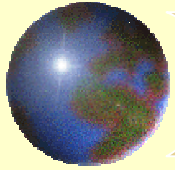
# History of Accreditation

- Several insolvencies in the late 1980's and early 1990's illustrated the weaknesses of state regulation.
- The Dingell report entitled "Failed Promises, Insurance Company Insolvencies" was released which fueled speculation about the imminent federal takeover of insurance regulation. The report illustrated the weaknesses of state regulation and the role the federal government should play in solvency regulation. The most significant weaknesses noted in the report were as follows:
  - Information provided by companies was not verified by regulators, independent auditors or qualified actuaries.



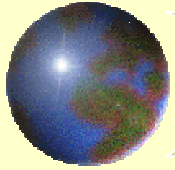
# History of Accreditation (Continued)

- Insufficient staffing and regulatory resources for solvency regulation were cited.
- Field examinations were normally done every three to five years; however, many states did not have mandatory requirements regarding the frequency of examinations.
- Interstate coordination and cooperation was virtually non-existent. Only a few states fully shared information with other states regarding financially troubled insurers.



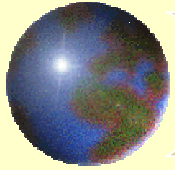
# History of Accreditation (Continued)

- The NAIC, governors and state legislatures realized something had to be done to address the inconsistencies in state regulation.
- A special committee was formed to address this issue and the accreditation program, along with other NAIC initiatives.



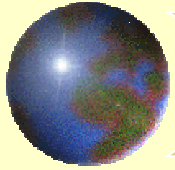
# NAIC Accreditation Program

- The Financial Regulation Standards (Standards) were adopted in 1989 to guide state legislatures and insurance departments in the development of effective solvency regulation.
- The Standards establish baseline requirements for an effective regulatory system in each state.
- A voluntary certification program was adopted in June 1990 and the first two states were accredited in December 1990.



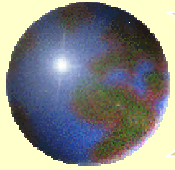
# NAIC Accreditation Program

- The program was developed by the NAIC in conjunction with state regulators, state legislators, and governors. The program received support from the insurance industry and trade associations and continues to receive this support.
- Each state insurance department that wants to be accredited is reviewed by an independent review team whose job is to assess the department's compliance with the Standards.



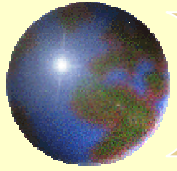
# NAIC Accreditation Program

- Currently, 47 states and the District of Columbia are accredited.
- The Financial Regulation Standards and Accreditation Committee (FRSAC) determines whether a state meets the requirements set forth in the Standards.
- The program focuses on multi-state property/casualty and life companies.



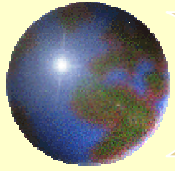
# Financial Regulation Standards

- Three Major Categories of Standards
  - Laws and Regulations
  - Regulatory Practices and Procedures
  - Organizational and Personnel Practices



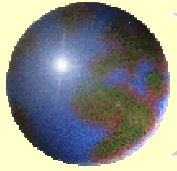
# Laws and Regulations

- States must adopt certain laws and regulations for solvency.
- 18 laws and regulations are currently required.
- The state must have all the laws and regulations in effect to be accredited (all or nothing).



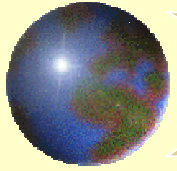
# Laws and Regulations

- Some of the key standards are:
  1. Examination Authority
  2. Corrective Action
  3. Risked Based Capital
  4. Reinsurance
  5. Investments
  6. Reserves
  7. Receiverships
  8. Guaranty Funds
  9. Accounting Practices



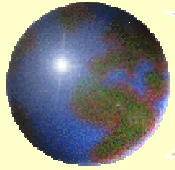
# Regulatory Practices and Procedures

- The following subsections contain standards that are scored separately:
  - Financial Analysis
  - Financial Examinations
  - Communication With States and Procedures for Troubled Companies
- Each standard is scored using a system which rates the state on a range from unacceptable (0) to excellent (5). An average score of 3 must be attained on both the financial analysis and examinations for a state to be accredited.



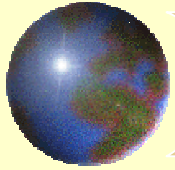
# Financial Analysis

- The eight standards are:
  1. Sufficient Qualified Staff and Resources
  2. Communication of Relevant Information to/from Financial Analysis Staff
  3. Appropriate Supervisory Review
  4. Priority-Based Review
  5. Appropriate Depth of Review
  6. Documented Analysis Procedures
  7. Reporting of Material Adverse Findings
  8. Action on Material Adverse Findings



# Financial Examinations

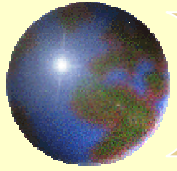
- The nine standards are:
  1. Sufficient Qualified Staff and Resources
  2. Communication of Relevant Information to/from Examination Staff
  3. Use of Specialists
  4. Appropriate Supervisory Review
  5. Use of Appropriate Guidelines and Procedures
  6. Scheduling of Examinations
  7. Examination Reports
  8. Reporting of Material Adverse Findings
  9. Action on Material Adverse Findings



# Communication With States and Procedures for Troubled Companies

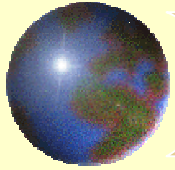
This subsection contains two standards.

- The two standards are:
  1. Communication with States
  2. Procedures for Troubled Companies



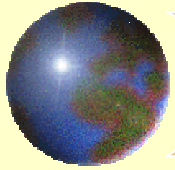
# Organizational and Personnel Practices

- Requires states to have effective human resource and organizational practices.
- These standards are not scored - only management comments are given.



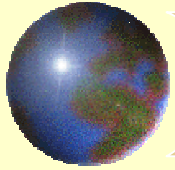
# Review Team

- The team normally consists of three to six individuals. A review team is selected and is normally made up of at least one of the following individuals:
  - Former regulator
  - Retired partner of a CPA firm
  - Attorney
  - Representative of the insurance industry
- One of the above individuals will be designated as the review team leader. In addition to the above individuals, an NAIC observer will be present to ensure uniformity and consistency in each review.



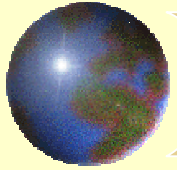
# Accreditation Review

- A state requests an accreditation review and a full week is scheduled.
- Prior to the on-site review the state can request a pre-review (usually six months to one year before) to be performed by a representative of the NAIC. This abbreviated review will give the state an idea of what improvements need to be made.
- The NAIC sends a resume of each team member for the state's review to help ensure independent review teams. The state will then indicate its approval or disapproval of the team.



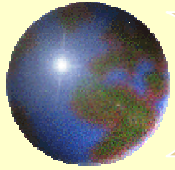
## On-Site Review

- Interviews with department personnel to gain an understanding of the organization and its processes.
- Review of laws and regulations.
- Review of examination reports and supporting work papers and interviews with examination staff. Normally, six examinations will be reviewed.
- Review of files prepared by the financial analysts and interviews with analysis staff. Normally, twelve files are reviewed.



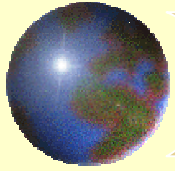
## On-Site Review (Continued)

- Review of organizational and personnel practices.
- Determine the state's compliance with the Standards.
- Closing conference with the state to discuss the findings of the review team where a compliance report and management letter will be presented. The state will be informed of the review team's decision as to recommend accreditation or not.



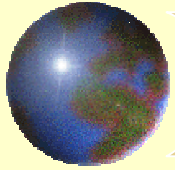
## Financial Regulation Standard and Accreditation Committee (FRSAC)

- The Subcommittee meets quarterly at the National Meetings to discuss the accreditation reviews performed during that quarter.
- The team leader of each review will present a report to the subcommittee and will indicate the review team's recommendation regarding accreditation.
- Based on this recommendation, the FRSAC will make a decision whether or not the state should be accredited.



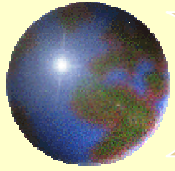
## Once Accreditation is Granted

- An accreditation award is presented at the National Meeting.
- A press release is issued that acknowledges the award of accreditation.
- Accreditation is for a five-year period, unless it is brought to the attention of the FRSAC that the state no longer meets the standards at which time accreditation will be suspended.



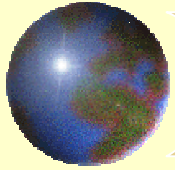
## Interim Annual Reviews

- On the annual anniversary of the state's accreditation the state shall submit an updated Financial Regulation Standards Self-Evaluation Guide along with a report that summarizes the changes from the previous year.
- The NAIC/SSO will review the document and present a report to the FRSAC at the quarterly meetings. The FRSAC will then determine if the state is still in compliance with the standards.



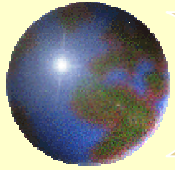
## Second Round Reviews

- On the fifth anniversary of the state's initial accreditation, the state is subject to a full on-site accreditation review.
- Currently, 46 states have completed the second-round review process.



# Evolving Standards

- As the insurance industry evolves, so must solvency regulation. The NAIC has anticipated that the Standards would not be static, but would be dynamic.
- In March 1998, the NAIC adopted a more flexible process for adding new/revised standards. The process seeks input from public officials, consumers, academics, regulators and industry representatives.

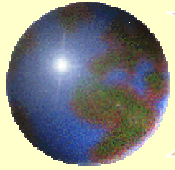


# How Accreditation Has Improved State Regulation

- The weaknesses of state regulation identified by Dingell's report, detailed earlier in the presentation, have been addressed by the NAIC as follows:

***Dingell Report:*** Information provided by companies was not verified by regulators, independent auditors or qualified actuaries.

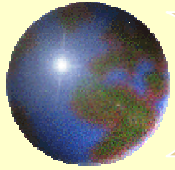
***NAIC:*** The financial regulation standards require states to have statutes or regulations that require annual audits by independent CPA's and actuarial opinions for their domestic insurance companies.



# How Accreditation Has Improved State Regulation

***Dingell Report:*** Insufficient staffing resources for solvency regulation were cited.

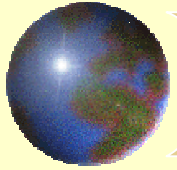
***NAIC:*** Many of the states did not have an adequate analysis function, if at all. In order to be accredited, many states were able to receive additional funds from their legislatures. Consequently, many states improved or added analysis staff and were able to improve other areas also.



# How Accreditation Has Improved State Regulation

***Dingell Report:*** Field examinations were normally done every three to five years; however, many states did not have mandatory requirements regarding the frequency of examinations.

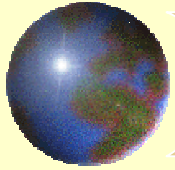
***NAIC:*** The standards require states to have the authority to examine companies whenever it is deemed necessary, but no less frequently than every five years.



# How Accreditation Has Improved State Regulation

***Dingell Report:*** Interstate coordination and cooperation was virtually non-existent. Only a few states fully shared information with other states regarding financially troubled insurers.

***NAIC:*** According to the standards, states should have a documented policy to cooperate and share information with respect to domestic companies with other state regulators. The state should also follow the NAIC *Troubled Insurance Company Handbook*.

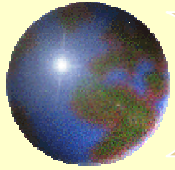


## Other

- International Accounting Standards
- NAIC/AICPA
- Guide to Compliance with State Audit Requirements
- Insurance Holding Companies
- Education and Training

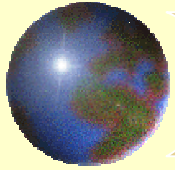


***Statutory Accounting  
Principles and  
Generally Accepted  
Accounting Principles***



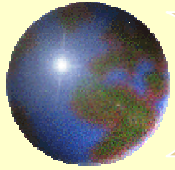
# *Codification of Statutory Accounting Principles*

- What is Statutory Accounting (SAP)?
- What are the differences between SAP and Generally Accepted Accounting Principles (GAAP)?
- What is Codification?
- Why is Codification needed?
- What are the most important parts of Codification?



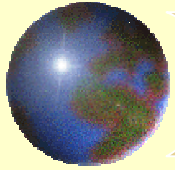
# *What is Statutory Accounting (SAP)?*

- SAP has been those accounting principles or practices prescribed or permitted by an insurer's domiciliary state.
- Statutory accounting practices have been interspersed in the insurance law, regulations and administrative rulings of each state and various NAIC manuals.
- SAP is conservative in some respects but not unreasonably conservative over the span of economic cycles, or in recognition of the primary statutory responsibility to regulate for financial solvency.
- SAP attempts to determine at the financial statement date an insurer's ability to satisfy its obligations to its policyholders and creditors



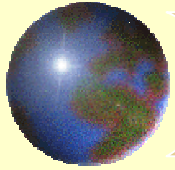
# *What are the differences between SAP and GAAP?*

- Objectives of GAAP reporting differ from the objectives of SAP.
- GAAP is designed to meet varying needs of the different users of financial statements.
- SAP is designed to address the concerns of regulators, who are the primary users of statutory financial statements.
- GAAP stresses measurement of emerging earnings of a business from period to period (i.e. matching revenue to expense).
- SAP stresses measurement of ability to pay claims in the future.



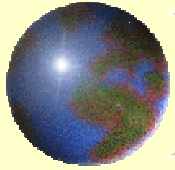
## *What is Codification?*

- Purpose is to produce a comprehensive guide to SAP
- 73 Statements of Statutory Accounting Principles (SSAPs)
- 88 Issue Papers
- 22 Appendices (acctg from Model Laws)
- Interpretations from Emerging Accounting Issues Working Group
- 1,948 pages of accounting



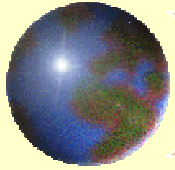
## *Why is Codification Needed?*

- Comprehensive guidance
- Many widely accepted statutory practices were not in the manuals (pensions, business combinations)
- Many areas have never been addressed
- Lack of uniformity among state requirements (no comparability)
- As the industry grew in size and complexity there was considerable divergence in accounting practices allowed by states
- Needed a well defined statement of concepts upon which to base decisions



## *What are the most important parts to Codification?*

- Effective date of Codification
- Name of Codification guidance
- Accreditation Standard
- Disclosure of differences between state basis and Codification



# *NAIC Accounting Practices and Procedures Manual*

## **Volume I:**

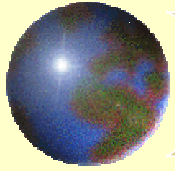
- Summary of Changes
- Table of Contents
- Preamble
- Statements of Statutory Accounting Principles
- Index to the Statements of Statutory Accounting Principles
- Glossary
- Appendix A – Excerpts of NAIC Model Laws
- Appendix B – Interpretations of the Emerging Accounting Issues Working Group
- Appendix C – Actuarial Guidelines
- Appendix D – GAAP Cross-Reference to SAP

## **Volume II:**

- Appendix E – Issue Papers
- Appendix F – Policy Statements

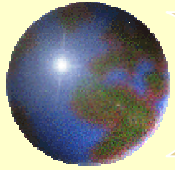


# *Financial Reporting*



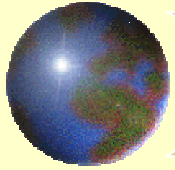
# *Financial Reporting*

- Annual Statements
- Quarterly Statements
- Management Discussion & Analysis
- Actuarial Opinion
- Annual Audited Financial Statements
- Risk-Based Capital Report



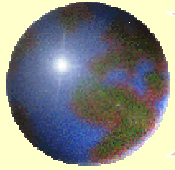
## *Annual & Quarterly Statements*

- Filed with the States and the NAIC
- Hardcopy Filing
- Electronic Filing
- Supplements
- Expenses, Premiums, Losses, Investments, Reinsurance, etc.



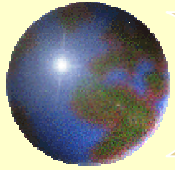
# *Management Discussion of Analysis & Actuarial Opinion*

- Filed with the States and with the NAIC
- Hardcopy Filing
- MD&A
- Actuarial Opinion



## *Annual Audited Financial Statements*

- Filed with the States and the NAIC
- Accountants Letter of Qualifications
- Financial Statements
- Designation of Independent CPA
- Notification of Adverse Financial Condition
- Report of Significant Deficiencies in Internal Controls



## *Risk-Based Capital Report*

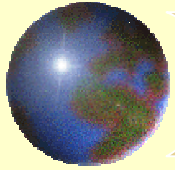
- Background on the Issue of Capital Structure
- Capital Regulation
- Risk-Based Capital Models
- Confidentiality
- Filed with the States and the NAIC
- Comparison of RBC Models for Various Financial Services Industries

*SECURITIES VALUATION  
OFFICE*



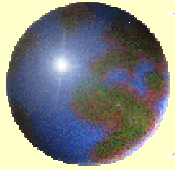
**Securities Valuation Office  
1411 Broadway, 9<sup>th</sup> Floor  
New York City  
212-398-9000**





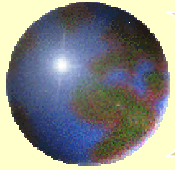
# *SECURITIES VALUATION OFFICE (SVO)*

- **CONDUCTS CREDIT ANALYSIS**  
(Designations)
- **DETERMINES STATEMENT VALUES**  
(Unit Price)



## *GOAL of SVO*

TO PROVIDE A UNIFORM  
VALUATION METHODOLOGY



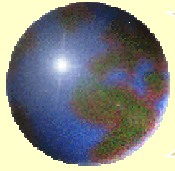
# ***SVO HISTORY***

**1907 COMMITTEE ON VALUATION OF  
SECURITIES**

**1908 VALUATION OF SECURITIES  
MANUAL**

**1940 NAIC**

**1949 SECURITIES VALUATION OFFICE  
OF THE NAIC**



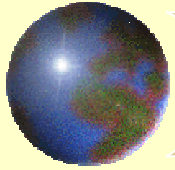
## ***TWO KEY PRINCIPLES***



### **ASSIST STATE REGULATORS**

- PROVIDE INVESTMENT INFORMATION**
- PROVIDE REGULATORY TOOLS**
  - INVESTMENT LIMITATIONS**
  - CAPITAL AND RESERVE REQUIREMENTS**

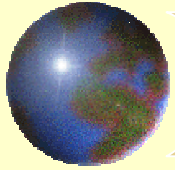




# ***TWO KEY PRINCIPLES***

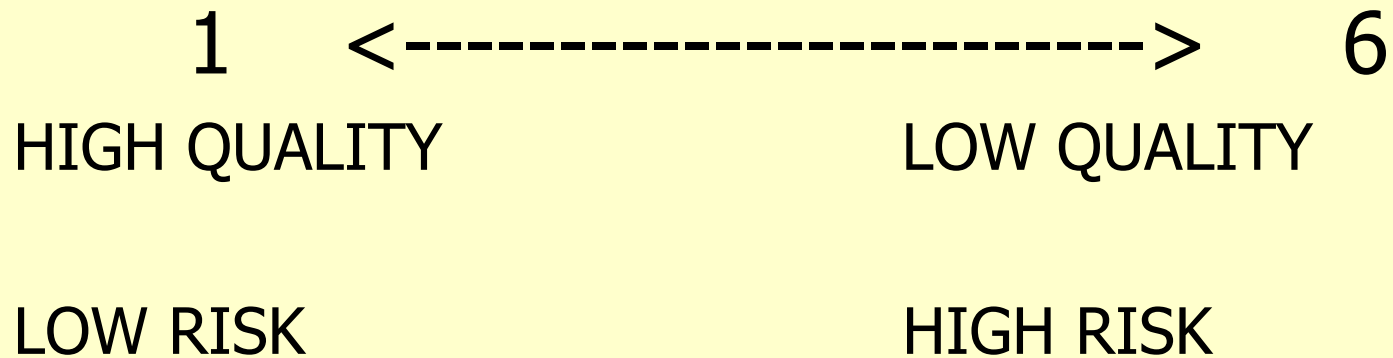
## ***(Cont'd.)***

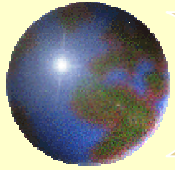
- ✌️ **PERFORM CREDIT ANALYSIS IN ACCORDANCE WITH THE “PURPOSES AND PROCEDURES (P&P) MANUAL”**
  - **ADOPTED BY VOS TASK FORCE**
  - **DEFINES ANALYTICAL METHODOLOGY**



# *SVO DESIGNATIONS*

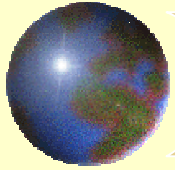
## CREDIT QUALITY RISK GRADATION





# ***SVO DESIGNATIONS***

- **EVALUATE CREDIT RISK**  
Ability to make Contractually  
Promised Payments
- **CLASSIFICATIONS:**  
Bonds, Preferred, Equity



# *SVO DESIGNATIONS*

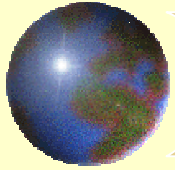
NATIONALLY

RECOGNIZED

STATISTICAL

RATING

ORGANIZATION

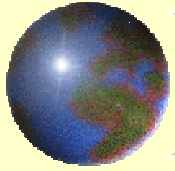


# ***NRSRO***

MOODY'S

STANDARD & POORS

FITCH IBCA (DUFF & PHELPS)

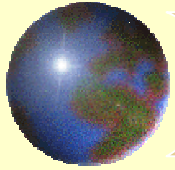


# ***SVO DESIGNATIONS AND EXTERNAL RATING EQUIVALENTS***

## **EXTERNAL RATING**

## **NAIC DESIGNATION**

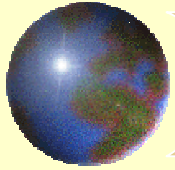
AAA, AA, A	1
BBB, Baa	2
BB, Ba	3
B	4
CCC, CC, C	5
IN OR NEAR DEFAULT	6



# ***SVO DESIGNATIONS***

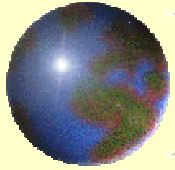
- **RATED SECURITIES:**
  - **VERIFY RATING**
  - **SPLIT RATING**
    - **ANALYZE RATIONALE OF NRSRO**
    - **DEVELOP RECOMMENDATION**

**PROVISIONAL EXEMPT (PE)**



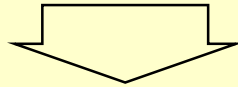
## ***SVO DESIGNATIONS***

- **NON-NRSRO RATED SECURITIES**
  - SVO ANALYSIS APPLY SIMILAR NRSRO DUE DILIGENCE STANDARDS
  - EXTENSIVE INFORMATION ANALYZED
- **REGULATORY IMPACT**
  - INVESTMENT LIMITATIONS
  - RISK BASED CAPITAL (RBC)
  - ASSET VALUATION RESERVE (AVR)



# *NAIC DESIGNATIONS*

SVO ANALYSTS  
REVIEW ISSUER'S  
FINANCIAL STATEMENTS



## NAIC DESIGNATIONS

- 1,2 - INVESTMENT GRADE
- 3 - BELOW INVESTMENT GRADE
- 4,5 - WAY BELOW INVESTMENT GRADE
- 6 - IN OR NEAR DEFAULT



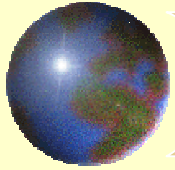
ANNUAL STATEMENTS OF LIFE  
COMPANIES WITH ASSET  
VALUATION RESERVE (AVR)

- 1 - 5 --- AMORTIZED VALUE
- 6 --- MARKET VALUE



ANNUAL STATEMENTS OF  
PROPERTY COMPANIES  
WITH NO AVR

- 1 - 2 --- AMORTIZED VALUE
- 3 - 6 --- MARKET VALUE



# ***SVO DESIGNATIONS***

## **ADMINISTRATIVE SYMBOLS**

**NR**

**NOT RATED**

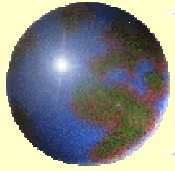
**Z**

**DESIGNATION/UNIT PRICE  
NOT DERIVED BY SVO**

**5\*/6\***

**AUDITED FINANCIAL  
STATEMENTS UNAVAILABLE**



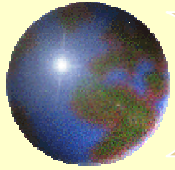


# ***SVO SERVICES FOR INSURANCE DEPARTMENTS***

- SECURITIES INFORMATION CLEARINGHOUSE
- EMERGING INVESTMENT VEHICLES (EIV)
- ADVANCED RATING SERVICE (ARS)
- LETTER OF CREDIT LIST
- MONEY MARKET FUND LIST
- COUNTERPARTY LIST
- SCHEDULE D COMPUTER AUDIT CAPABILITY
- NAIC/SVO WEBSITE

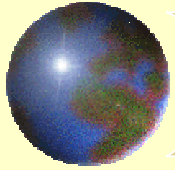


***Alien Insurers Writing Direct  
Coverage in the U.S.***



## *Alien Insurers Writing Direct Coverage*

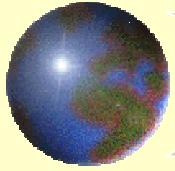
- Nonadmitted alien insurers must file financial statements, copies of auditors' reports, names of their U.S. attorneys, details of their U.S. trust
- Capital and/or surplus, U.S. trust accounts, and character, trustworthiness and integrity will be evaluated



## *Capital and/or Surplus Funds*

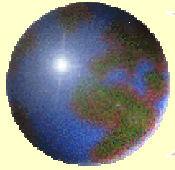
### Factors Considered:

- Size of Company measured by assets, capital, reserves, premiums writings, in force policies;
- Type of business written;
- Past and projected trends of company
- A company must possess enough surplus to meet it's obligations and never be less than \$15,000,000 for any one company.



## *U.S. Trust Account*

- No less than 5,4000,000 plus
- For liabilities written after 1/1/98, 30% of either
- The Company's U.S. gross surplus lines liabilities; or
- The Company's direct non-admitted U.S. liabilities excluding liabilities arising from aviation, wet marine and transportation insurance and direct procurement.

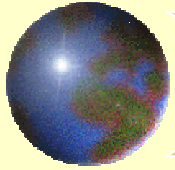


## *Character, Trustworthiness and Integrity*

- The insurer shall have an established reputation of financial integrity and satisfactory underwriting and claims practices.

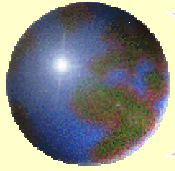


# **Regulating Reinsurance for Solvency**



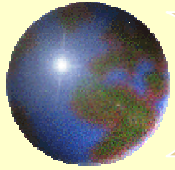
# U.S. Regulation of Reinsurance

- State Level
- Predicated Upon Solvency
- Minimum Capital & Surplus Requirements
- Risk Based Capital Standards
- Examination Authority
- Holding Company Regulation
- Domestic Reinsurers = Primary Insurers
- Credit for Reinsurance
- Regulation of Reinsurance Intermediaries



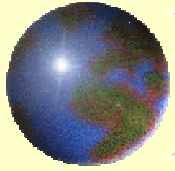
## NAIC Models

- Credit for Reinsurance Model Law
- Credit for Reinsurance Model Regulation
- Assumption Reinsurance Model Act
- Reinsurance Intermediary Model Act
- Disclosure of Material Transactions Model Act



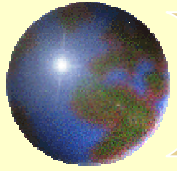
# Credit For Reinsurance

- Benefit To Ceding Carrier
  - Reduction in Liabilities
  - Increase in Assets



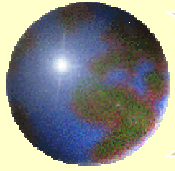
## Classes of Reinsurers

- Reinsurer is Licensed in Ceding Company's Domicile
- Reinsurer is Accredited
- Reinsurer is Licensed in a "*Substantially Similar State*"
- Trust Fund Reinsurer



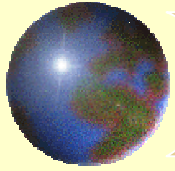
## Licensed Reinsurer

- Same State as Ceding Company
- Licensed for "*Like Kind of Business*"



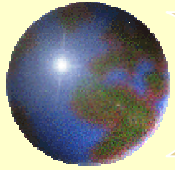
## Accredited Reinsurer

- Must Submit To Enacting State's Jurisdiction
- Must Submit To Enacting State's Examination Authority
- Reinsurer Must be Licensed in at Least 1 State
- Reinsurer Must File Its Annual Financial Statement
  - To Ceding Company's Domiciliary State
- Maintain Policyholder Surplus of at Least \$20 million



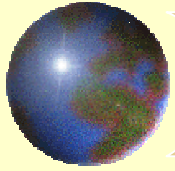
## Substantially Similar State

- Licensed for "*Like Kind of Business*"
- Reinsurer Must Submit To Enacting State's Examination Authority
- Policyholder Surplus of at Least \$20 million



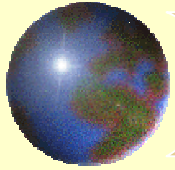
## Trust Fund Insurer

- Domiciliary Commissioner Approval Needed
  - Trust & Amendments
- or
  - Another State Accepts Regulatory Responsibility
- Trust Form & Amendments Must be Filed in All States Where Risks are Located



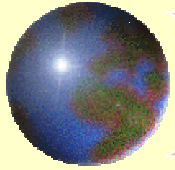
# Trust Fund Insurer

- Contested Claims
  - Valid & Enforceable In Any U.S. Court of Competent Jurisdiction
- Trust Vests Legal Title to Assets to Trustees
  - For benefit of the Ceding Company
- Trust & Assuming Insurer Shall be Subject to Examination



## Trust Types

- Single Assuming Insurer
- A Group Including Incorporated and Individual Unincorporated Underwriters
- A Group of Incorporated Underwriters Under Common Administration

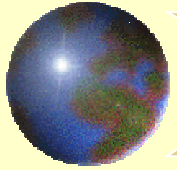


# Single Assuming Insurer

- \$20 Million of Trusteed Surplus

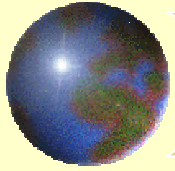
and

- Assuming Insurer's Total Liabilities  
Attributed to Reinsurance Ceded by  
U.S. Insurers



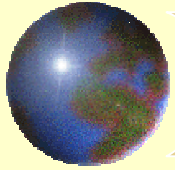
# Group of Incorporated & Individual Unincorporated Underwriters

- After 8/1/1995
  - The Trust Not Less Than the Groups Several Liabilities Attributable to Business Ceded by U.S. Domiciled Ceding Insurers
- Before 7/31/95
  - The Trust shall consist of the Group's several liabilities attributable to Business written in the U.S.
- \$100 Million of Trusteed Surplus
- 90 Days After Financial Statements Are Due
  - Audited Financial Statements or
  - Certification by Group's Domiciliary Regulator
    - Solvency of Each Underwriter Member



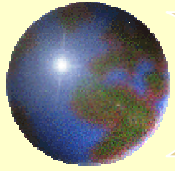
## Group of Incorporated Underwriters Under Common Administration

- Trust Fund Amount: Not Less than the Group's Several Liabilities
  - Attributed to Business Ceded by U.S. Ceded Insurers to Any Group Member
- \$100 Million Trusteed Surplus
  - Held Jointly for Benefit of U.S. Domiciled Ceding Insurers of Any Member of the Group
- \$10 Billion Aggregate Surplus



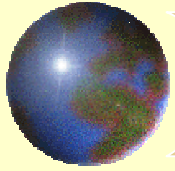
# Group of Incorporated Underwriters Under Common Administration

- Submits to U.S. Court of Competent Jurisdiction
- Service of Process
  - Appoints Enacting State's Commissioner or Designated Attorney Agent
- 90 Days After Financial Statements Are Due
  - Audited Financial Statements
  - Certification by Group's Domiciliary Regulator
    - Solvency of Each Underwriter Member



## *Domestic Insurer May Reduce Its Liabilities by An:*

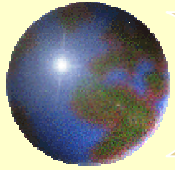
- Amount Not Exceeding the Liabilities Carried by the Ceding Insurer
- Amount of Funds Held by or on Behalf of the Ceding Insurer
- Amount of a Trust Held in a Qualified U.S. Financial Institution



# *Security in the form of:*

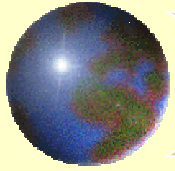
## Cash

- Securities Listed by the SVO of the NAIC As Qualified Admitted Assets
- Letters of Credit
  - Clean
  - Irrevocable and Unconditional
- Any Other Form Acceptable to the Commissioner



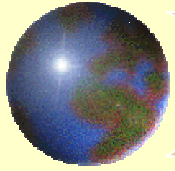
# Credit For Reinsurance Model Regulation

- **Asset Requirements**
  - Must Be Valued at Fair Market Value
  - Must Consist of
    - Cash or Certificates of Deposit Issued by U.S. Financial Institutions
  - Other Investments May Be Authorized
    - Government Obligations (Payable From Taxes & Related Revenue)
    - Government Obligations of OECD Member If Rated A or Higher by NAIC SVO
    - Obligations of a Multinational Development Bank If Rated A or Higher by a Recognized Agency



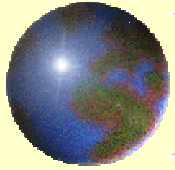
# Credit For Reinsurance Model Regulation

- Asset Restrictions
  - No More Than 20% May Be Foreign Investments
  - No More Than 10% May Be Dominated in Foreign Currencies
  - Investments Issued by Grantors, a Party Controlled by the Grantor, or a Beneficiary, Shall Not Exceed 5% of the Total Investments
  - A Mortgage Related Security May Not Exceed 5% of Trust Assets



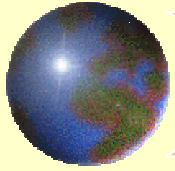
# Reinsurance Intermediary Model Act

- Adopted by NAIC in 1989 (Amended 1990 & 1993)
- Incorporated in NAIC Accreditation Program in 1990
- Adopted by Nearly All States in Some Form
- Requires Certain Contract Provisions Between Intermediary and the Party It Represents



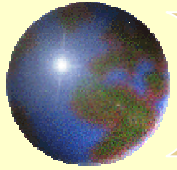
# Types of Reinsurance Intermediaries

- Reinsurance Intermediary Broker
  - Acts on Behalf of Ceding Insurer
  - Does Not Have Authority to Bind Ceding Insurer
  - Licensed as a
    - Resident Producer
    - Non Resident Intermediary



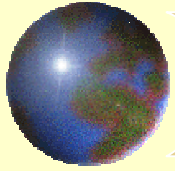
# Types of Reinsurance Intermediaries

- Reinsurance Intermediary Broker Must
  - Render Accurate Accounts to the Ceding Insurer
  - Remit Funds Within 30 Days of Receipt
  - Retain Funds Collected in a Fiduciary Capacity in a Qualified U.S. Financial Institution



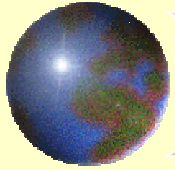
# Types of Reinsurance Intermediaries

- Reinsurance Intermediary Manager
  - Acts on Behalf of Assuming Reinsurer
  - Authority to Bind Assuming Reinsurer or
  - Manages All or Part of the Reinsurer's Assumed Business



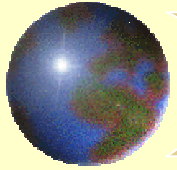
# Types of Reinsurance Intermediaries

- Reinsurance Intermediary Manager
  - Licensed as a
    - Resident Producer
    - Non Resident Intermediary
  - May not be
    - An Employee of the Reinsurer
    - A U.S. Manager of a Branch of an Alien Insurer
    - A Pool Manager of a Residual Market Mechanism
    - An Underwriting Manager Under Common Control With the Reinsurer and Subject to Holding Company Act



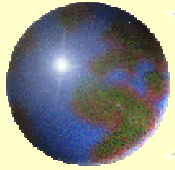
# Types of Reinsurance Intermediaries

- Reinsurance Intermediary Manager Must
  - Render Accurate Accounts to the Reinsurer
  - Remit Funds Due the Reinsurer on a Monthly Basis
  - Retain Funds Collected in a Fiduciary Capacity in a Qualified U.S. Financial Institution
  - Retain No More Than 3 Months Estimated Claims Payments & ALAE
  - Maintain a Separate Bank Account for Each Reinsurer Represented



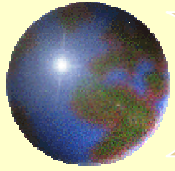
# Types of Reinsurance Intermediaries

- Both Reinsurance Brokers and Managers Must....
  - Retain Complete Records of Transactions for at Least 10 Years
  - Permit Access to and Right to Copy Records by Client
  - Comply With Written Standards Established by the Insurer for Cession of Risks



# Duties Imposed Upon Reinsurer and Insurer

- Prohibition Against Using Unlicensed Reinsurance Broker or Manager
- Prohibition Against Employing Individual Controlled by the Intermediary Unless Parties Are Under Common Control
- Requirement That the Insurer or Reinsurer Obtain Financial Statement of the Intermediary

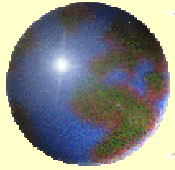


## Duties Imposed Upon Reinsurer

- If Reinsurance Manager Establishes Loss Reserves, Reinsurer Must Obtain Annual Opinion of Reserve Adequacy
- Binding Authority for All Retrocessions Rests With Officer of the Reinsurer
- Reinsurer Shall Not Appoint to Its Board of Directors Anyone Associated With the Reinsurance Manager

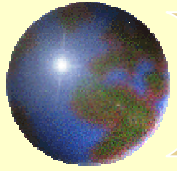


# REGULATING INSURER INSOLVENCIES



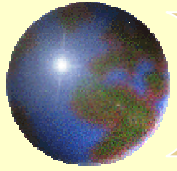
## *HISTORY-Source of Authority*

- 11 U.S.C . § 109 (b)(2)
  - “Domestic Insurance Companies” Excluded
  - Areas of Uncertainty
    - Health Care Entities
    - Mutual Holding Companies



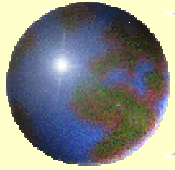
# *State Regulatory Scheme*

- State Statutes
  - Extent of Jurisdiction
  - Insurance Commissioner Commences Proceeding
  - Insurance Commissioner Appointed Receiver
  - State Court Supervises Proceeding
  - Receiver's Actions Reviewed Under Abuse of Discretion Standard



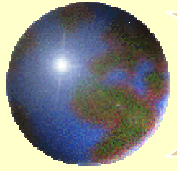
# **Insolvencies in the U.S - Two Main Causes**

- Fraud
- Mismanagement



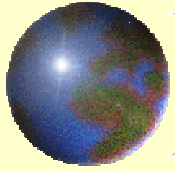
## *Insolvencies - Specific Causes*

- Looting
- Transactions with affiliates
- Rapid growth
  - Premium outgrows surplus
  - Expansion into new lines of business
  - Expansion into new geographic areas



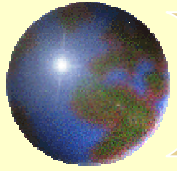
## *Insolvencies - Specific Causes*

- Inappropriate pricing
- Inappropriate underwriting
- Bad product mix
- Inadequate reserves
- Inadequate reinsurance program
- Poor claims administration



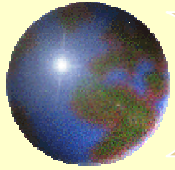
## **Insolvencies - Specific Causes**

- Uncollectible reinsurance recoverables
- Assumed reinsurance
- Bad investment strategy
- Excessive Expenses
- Lack of effective internal controls



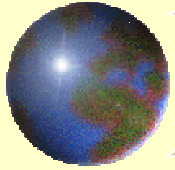
# *REGULATORY RESPONSES*

- Administrative
  - Warning Letter
  - Corrective Order
  - Supervision



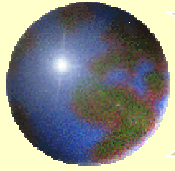
# *REGULATORY RESPONSES*

- Judicial
  - Seizure
  - Conservation/Rehabilitation
  - Liquidation



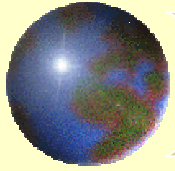
# *REGULATORY RESPONSES*

- Seizure
  - Court May Issue Ex Parte Seizure Order
  - Full Hearing Within 7-30 Days



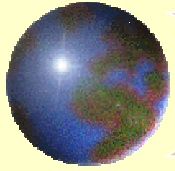
# *REGULATORY RESPONSES*

- Rehabilitation
  - Receiver Must Determine Whether Insurer Can Be Rehabilitated
  - Receiver Prepares Plan
  - Supervising Court Determines Whether to Approve Plan
  - If Approved Plan Put into Effect



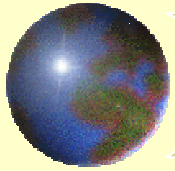
# *REGULATORY RESPONSES*

- Liquidation (typical)
  - Fixing Date Established
    - Cancellation of Policies
    - Voidable Preferences
  - Claims Bar Date Established
  - Assets Marshaled and Liquidated
  - Claims Adjudicated
  - Distribution to Creditors According to Liquidation Priority Statute
  - Closure of Estate

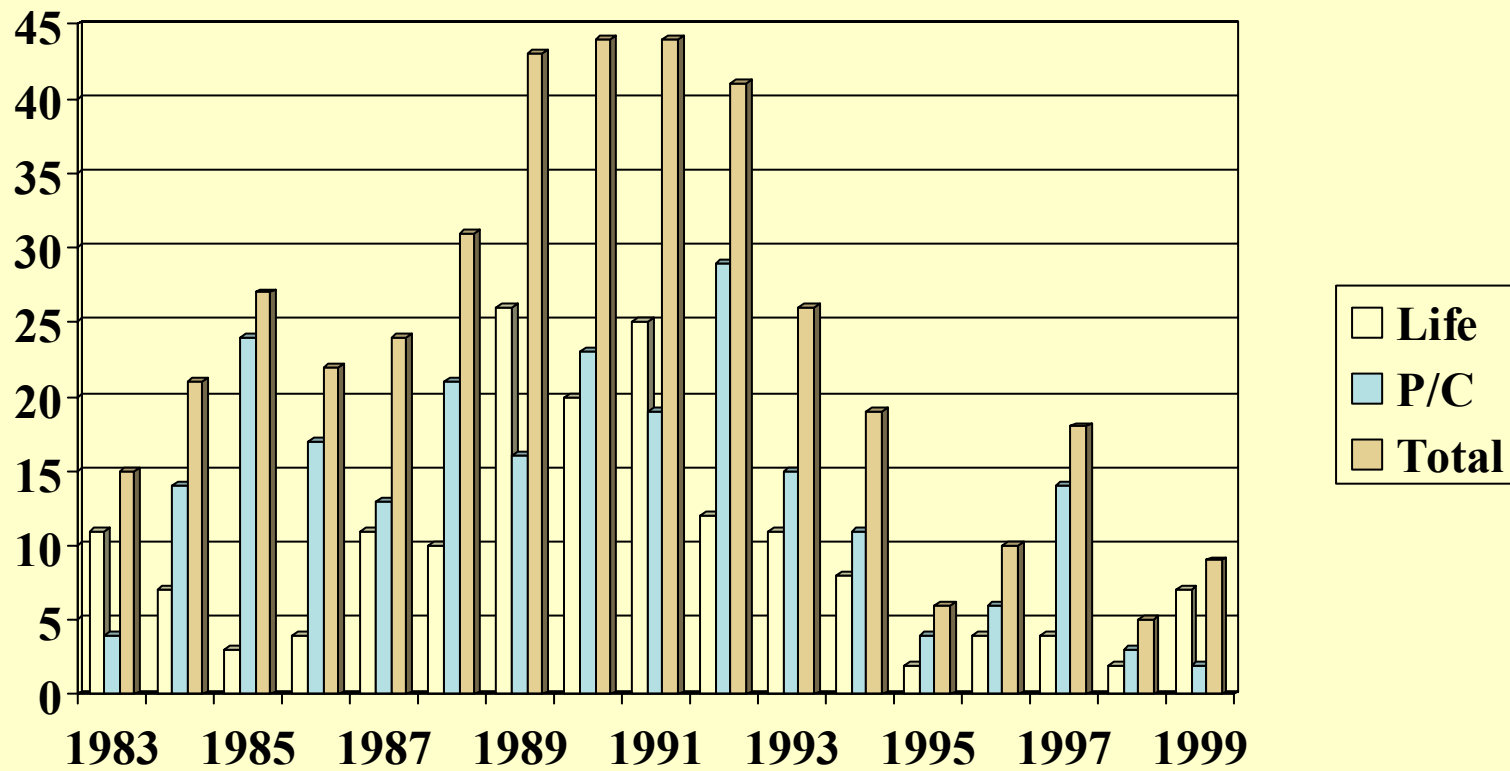


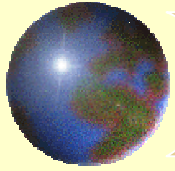
# *REGULATORY RESPONSES*

- Liquidation (life insurer)
  - Nature of Contracts such that Cancellation Is not Good Option
  - Put Blocks of Business out for Bids
  - Arrange for Assumption of Policies by Healthy Insurer



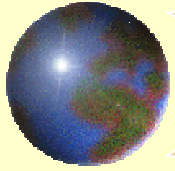
# *MULTISTATE INSURER INSOLVENCIES*





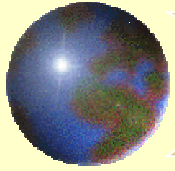
## ***GUARANTY FUND SYSTEM***

- Created by State Statute
- Typically Separate Entities for Property/Casualty and Life/Health
- All Licensed Insurers Are Required to Participate
- Post Insolvency Pro Rata Assessments
- Various Recoupment Mechanisms



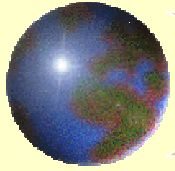
## ***GUARANTY FUND SYSTEM***

- **Property/Casualty Guaranty Funds**
  - Coverage Up to \$300,000 Per Claim
  - No Limit for Workers' Compensation
  - Net Worth Exclusion
  - Assume Responsibility for "Covered Claims"



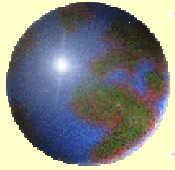
# ***GUARANTY FUND SYSTEM***

- Life/Health/Annuity
  - Life
    - \$300,000 Death Benefits
    - \$100,000 Cash Surrender/Withdrawal
  - Health
    - \$500,000 Basic Medical
    - \$300,000 Disability
    - \$100,000 Other



# *GUARANTY FUND SYSTEM*

- Annuities
  - \$100,000 Individual
  - \$100,000 Structured Settlement
  - \$5,000,000 Unallocated Contracts
- Equity-Indexed Products
- Interest Rate Rollback
- May Assume Responsibility for “Covered Claims”
- May Participate in Assumption Reinsurance Transaction

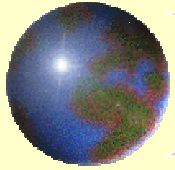


# *ISSUES IN THE INSOLVENCY ARENA*

- Priority of Federal Claims
- Long Tail Liabilities and Closing Estates
- Managed Care Organizations

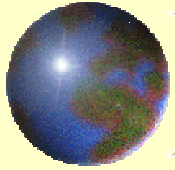


# **Regulatory Perspectives of the NAIC**



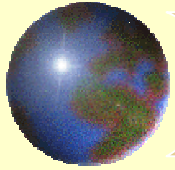
## Regulatory Topics:

- The Gramm-Leach-Bliley Act (GLBA)
- The NAIC's Response to the GLBA
- The Statement of Intent
- Other Regulatory Initiatives
  - National Treatment
  - Speed to Market
  - Consumer Protection
- Electronic Commerce and Regulation



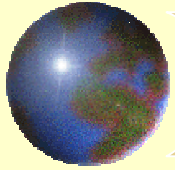
# The Gramm-Leach-Bliley Act

- Facilitating Affiliation Among Banks, Securities Firms and Insurers
- Repeal of the Glass-Steagall Act
- Affirmation of McCarran-Ferguson Act
- Creation of Financial Holding Companies
- Functional Regulation
- Cooperation Among Functional Regulators



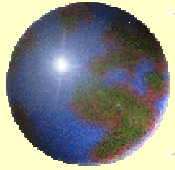
# The Gramm-Leach-Bliley Act

- Who are the Functional Regulators?
  - State Insurance Regulators
  - The Securities and Exchange Commission
  - The Board of Governors of the Federal Reserve System (The Fed)
  - The Office of Thrift Supervision (OTS)
  - The Office of the Comptroller of the Currency (OCC)
  - The Federal Deposit Ins. Corp. (FDIC)



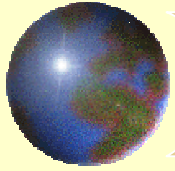
# The Gramm-Leach-Bliley Act

- Preemption of Certain State Anti-Affiliation Laws
- Preemption of Certain State Redomestication Laws
- Establishment of NARAB
- Consumer Protection Laws
- Privacy Laws and Regulations



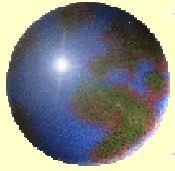
# The NAIC's Response to GLBA

- Action Rather than Inaction
  - 2000 Commissioner's Conference
  - Taking Radical Steps to Assure that the Functional Regulation of Insurance will be Viable and that all Deadlines in the GLBA will be met
  - Revamping NAIC Meeting Structure to get the Job Done
  - Developing the Statement of Intent



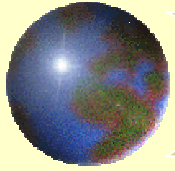
## Statement of Intent

- A Bold Statement by Insurance Regulators of Their Intent to Not Only Meet the Demands of the GLBA, but to Take Radical Steps to Modernize Insurance Regulation
- Has Led to the Formation of Nine Commissioner-Level Working Groups to Develop and Implement Plans for Regulatory Reform



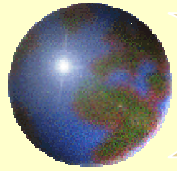
# Statement of Intent

- Mandates Contained in the GLBA
  - Amendments to State Laws
  - Streamlined Licensing for Producers
  - Financial Examinations and Reviews of National Companies
  - Implementing Functional Regulation and Information Sharing



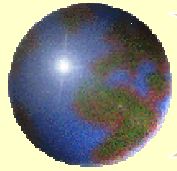
## Statement of Intent

- Optional Steps to Modernize Insurance Regulation
  - Speed to Market Initiative
  - Regulatory Re-engineering
  - Market Conduct Reform
  - Facilitating Beneficial Electronic Commerce
  - Treatment of National Insurers
  - Uniform Certificate of Authority Application (UCAA)



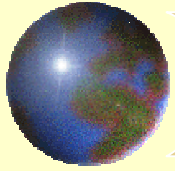
# *Uniform Certificate of Authority Application (UCAA)*

- The Primary Application to the Uniform Certificate of Authority Application (UCAA) is designed for use in the formation of a new insurer, or by an existing insurer that is making application to redomesticate to another state. A Uniform State is one that is committed to using the UCAA review process for company licensing and admissions.



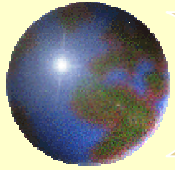
# *Uniform Certificate of Authority Application (UCAA)*

- Each state's review process may follow slightly different time lines to complete a comprehensive and detailed operational and financial review of the applicant's business. It is the goal of all Uniform States to complete their review of Primary Applications within 90 calendar days of receipt. The 90-day review process includes two weeks to determine if the application is complete and acceptable for filing. During the remaining time-span the application will receive a financial and operational review. The 90-day processing goal may not be achieved in instances where substantial follow-up is required, or in states with limited resources, or in instances when applications are filed during peak business periods such as year-end and annual statement filing periods.



## Other Regulatory Initiatives

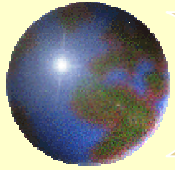
- Financial Data Re-engineering
- SERFF
- PDB/PIN
- ALERT
- Market Regulatory Databases
  - CDS
  - RIRS
  - SAD



# *REGULATORY MODERNIZATION*

## **National Treatment Working Group Statement of Intent**

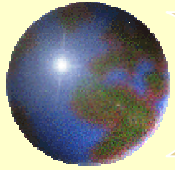
We are committed to exploring all options that offer greater uniformity within the state-based system of insurance regulation that could provide the same efficiencies as a federal charter for insurance companies.



# *NATIONAL TREATMENT OF COMPANIES*

## **Focus & Options**

- Regulatory Processes
- Company Eligibility
- Regulatory Participants
- Ultimate Goals

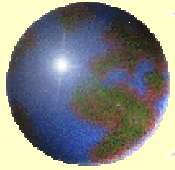


# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Processes**

### **Group A**

- New charters
- Expansion licenses for existing companies
- Expanded lines of authority
- Change of name
- Authority for removal of books of record
- Approval for out-of-state home office

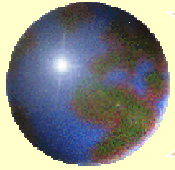


# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Processes**

### **Group B**

- Annual and quarterly financial statement review
- Financial exams
- Investment compliance
- Affiliate transactions
- Mergers, acquisitions, sales and changes of control
- Reorganizations and demutualizations

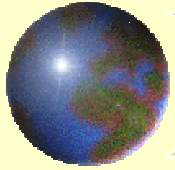


# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Processes**

### **Group C**

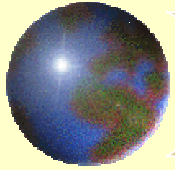
- Selected market conduct processes
- Referred to Market Conduct Working Group



# *NATIONAL TREATMENT OF COMPANIES*

## **Company Eligibility/Operating Standards**

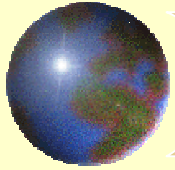
- RBC at 400 percent - referred to RBC Task Force
- Financial reporting & accounting procedures
- Diverse investment policy – Defined limits model
- Acceptable ratings – raised from BBB to A- rating
- Annual unqualified audit
- Senior management experience



# *NATIONAL TREATMENT OF COMPANIES*

## **Company Eligibility/Operating Standards**

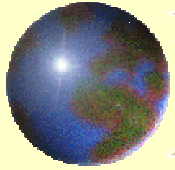
- Annual opinion from “qualified actuary”
- Reinsurance credits meeting NAIC standards
- Parent and affiliates must be in good standing with creditors
- Parent and affiliates in good standing with regulators
- Three-year financial condition examination
- Compliance with Market Conduct standards



# NATIONAL TREATMENT OF COMPANIES

## Company Eligibility Requirements & Operating Standards for National Treatment

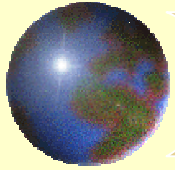
			<b>Life # of COS.<i>before</i> RBC</b>	<b>Life # of COS.<i>after</i> RBC</b>	<b>P/C # of COS.<i>before</i> RBC</b>	<b>P/C # of COS.<i>after</i> RBC</b>
<u>Options</u>	<u>State Licenses</u>	<u>Minimum Premium*</u>	<u>Standard</u>	<u>Standard</u>	<u>Standard</u>	<u>Standard</u>
1	2 or more		770	700	1300	1100
2	5 or more	50 Million	350	323	510	421
3	25 or more	100 Million	254	230	286	226
4	25 or more	250 Million	170	155	162	123
*Direct Premium Written Based on 400% of ACL						



# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Participants—**

- **Eligibility Criteria for States**
- **Which State or States Regulate?**

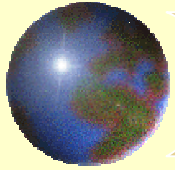


# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Participants--Criteria**

### ***Two Options:***

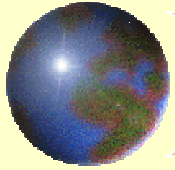
- **Any member of the NAIC is eligible;**  
**or**
- **Any accredited member of the NAIC is eligible**



# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Participants—Who Regulates?**

1. Domiciliary Only
  - With review by National Treatment Task Force (similar to FAWG)
2. Domiciliary Plus
  - States with greatest premiums
3. Enhanced Pool of Resources
  - Contractors
  - NAIC staff

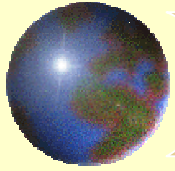


# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Participants—Who Regulates?**

### ***Pros***

1. Domiciliary Only
  - Clear line of authority and clarity
2. Domiciliary Plus
  - States with greatest regulatory interest involved
3. Enhanced Pool of Resources
  - Additional resources for under-staffed Departments

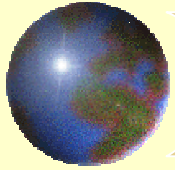


# *NATIONAL TREATMENT OF COMPANIES*

## **Regulatory Participants—Who Regulates?**

### ***Cons***

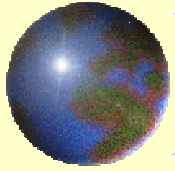
1. Domiciliary Only
  - One state could weaken national system
2. Domiciliary Plus
  - Changes in higher premium states
  - Conflicts between states
3. Enhanced Pool of Resources
  - Costs and coordination



# *NATIONAL TREATMENT OF COMPANIES*

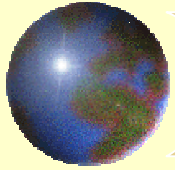
## **NAIC Next Steps**

1. Use of UCAA: Obtain commitments from all NAIC members to participate in the UCAA program by December 2000 and to actively participate by June 2001.
2. Adoption of Best Practices: Develop “best practices” for reviewing significant holding company transactions and company licensing applications by December 2000 and June 2001, respectively



# *TREATMENT OF NATIONAL COMPANIES*

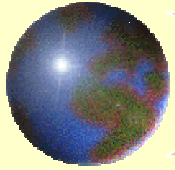
3. Implementation by MOA: Implement national treatment process through memorandum of agreement between June 2001 and June 2002.
4. Possible State Legislation: If necessary, develop enabling state legislation to implement any component of national treatment system requiring statutory changes for enactment by June 2003



## *SPEED TO MARKET*

### **Two Subgroups Formed**

- CARFRA (Coordinated Advertising, Rate and Form Review Authority)
- Improvements to State Based Systems

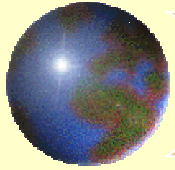


## *SPEED TO MARKET*

### **CARFRA**

Coordinated Advertising, Rate, and Form Review Authority

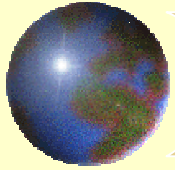
- For regulators, it provides assistance and greater expertise in the review and approval of rate, form and advertising filings.
- For companies, it provides a single point of contact and national standards.
- For consumers, it speeds products to market while preserving high quality regulatory review.



## *SPEED TO MARKET*

### **CARFRA**

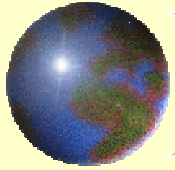
- Each member state may contribute staff to assist with review. These staff will make up the CARFRA review pool.
- CARFRA will select review teams from the pool to review a filing.
- The filings will utilize an electronic repository. State regulators will complete the review from their state offices.
- CARFRA will require a limited staff for administering the repository.



## *SPEED TO MARKET*

### **CARFRA -- Review**

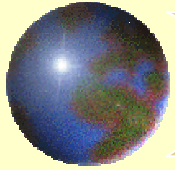
- A review will begin when rates, forms and/or advertising are filed with the CARFRA electronic repository.
- A review team will be appointed from the pool.
- The team will review the filing according to the national standards. There will be opportunity for additional input to the review team from all member states during the review.



## *SPEED TO MARKET*

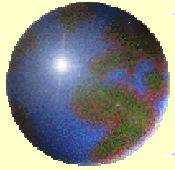
### **CARFRA--Review**

- The review team's decision will be communicated to the states for comment.
- An appeal committee will be available for states and the filing company.
- The review decision is adopted by the states.



## Benefits of CARFRA

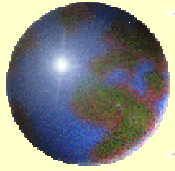
- The process:
- Acts as a consultant service for the states providing product review expertise
- Offers predictability in approval, standards and process
- Is a mechanism for national review standards
- Remains an optional process – filings will still be available on a state-by state basis
- Maintains state control



## *SPEED TO MARKET*

### **Benefits of CARFRA**

- Provides for equal involvement by all states,
- Remains state-based and
- Allows for enhanced solvency monitoring, market conduct, and other consumer protections.

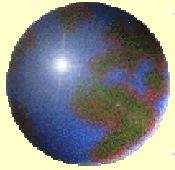


## *SPEED TO MARKET*

### **CARFRA**

This process is analogous to the state securities Coordinated Equity Review, with two differences:

- There are far fewer securities products, and
- Federal securities regulation is extensive, minimizing state regulation.

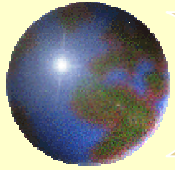


## *SPEED TO MARKET*

### *Improvements to State Based System*

The subgroup will evaluate suggestions for improving state based systems

- Implementation of SERFF
- Uniform definition of Exempt Commercial Policyholder
- Eliminate Desktop Rules
- Move away from prior approval
- Improvements to Market Conduct examination process
- Enhance consumer education



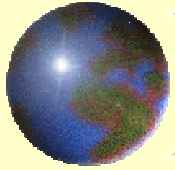
## *SPEED TO MARKET*

### *Improvements to State Based System*

- Tasked with the responsibility of developing specific proposals by the December 2000 NAIC National Meeting
- Intensive meetings underway to meet this goal

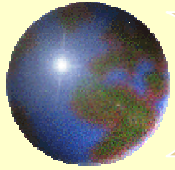


# **Electronic Commerce**



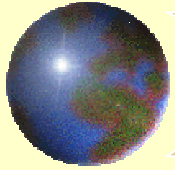
# Electronic Commerce

- What is the NAIC doing regarding online insurance?
  - The Electronic Commerce and Regulation Working Group of the Regulatory Reengineering (G) Task Force is responsible for addressing issues regarding sales of insurance on the Internet. Current activities include an issues paper, the study of various legislation, and the study of existing signature requirements in various state regulations and laws. Other working groups are active in the insurer to regulator portion of the online insurance world.



# Electronic Commerce

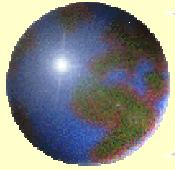
- General Guidelines
- Retention of Consumer Safeguards is Paramount
- Where possible, existing law and regulation should be interpreted to include electronic transactions, rather than creating new laws and regulations
- E-Commerce Insurance should carry no more of a regulatory “burden” than traditional insurance business



# ***NAIC Electronic Commerce and Regulation Working Group CHARGE***

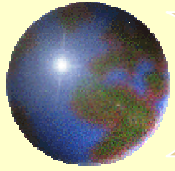
## **➤ Electronic Commerce:**

- ✓ **Develop specific recommendations to update and harmonize state laws and regulations to:**
  - ✓ **Facilitate the use of E-Commerce by insurers.**
  - ✓ **Allow improvement in the cost and quality of access to, and delivery, and administration of insurance products and services, and**
  - ✓ **Maintain and improve necessary consumer protections.**



# ***NAIC Electronic Commerce and Regulation Working Group CHARGE***

- **Electronic Regulation:**
  - ✓ Evaluate methods by which the Internet and other means of E-Commerce can increase efficiencies in regulating insurance.

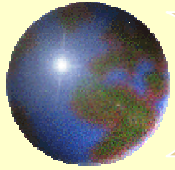


# ***NAIC ISSUES PAPER***

## ***Electronic Regulation***

### **State Regulation Goals:**

- ✓ **Eliminate licensing and approval barriers.**
- ✓ **Leverage technology and automation initiatives to achieve economies of scale.**
- ✓ **Increase uniformity and consistency across state boundaries.**



# ***NAIC ISSUES PAPER***

## ***Electronic Regulation***

### **Major Impact Areas**

#### **1) Agent licensing**

- National Insurance Producer Registry (IRIN)
- Producer Information Network: 27 States
- Producer Database: 33 States

#### **2) Rate and form filing**

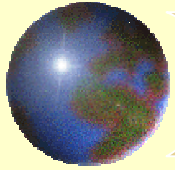
- Electronic Filing (SERFF): 45 States

#### **➤ ALERT Project:**

- Uniform Certificate of Authority Application (UCAA): 47 states
- National Treatment of Companies

#### **4) Financial reporting**

- Financial Database Reengineering: New

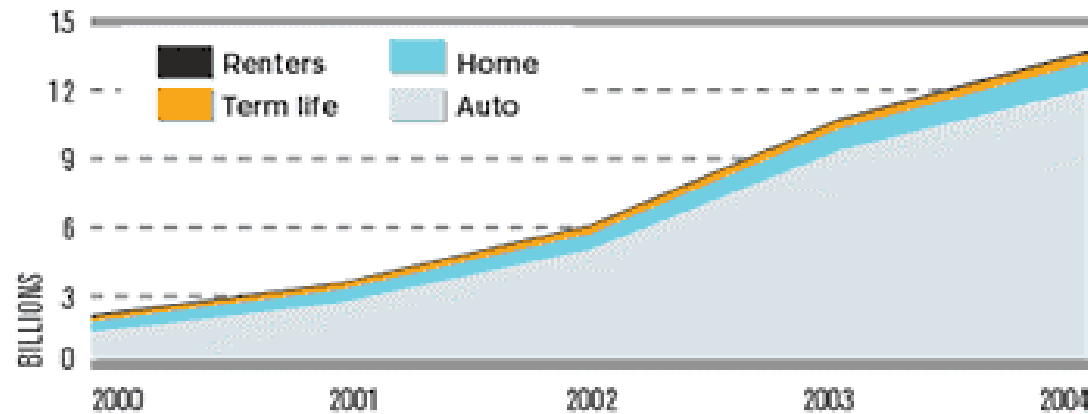


# ***E-COMMERCE***

## ***Market Opportunity***

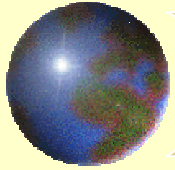
### **AUTO COVERAGE DOMINATES ONLINE INSURANCE**

**U.S. Online Insurance Spending Forecast by Type**



	2000	2001	2002	2003	2004
Auto	\$1.2	\$2.5	\$4.8	\$9.1	\$11.8
Home	\$0.5	\$0.6	\$0.7	\$0.9	\$1.2
Term life	\$0.2	\$0.3	\$0.3	\$0.4	\$0.4
Renters	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
<b>Total</b>	<b>\$2.0</b>	<b>\$3.5</b>	<b>\$5.9</b>	<b>\$10.5</b>	<b>\$13.5</b>

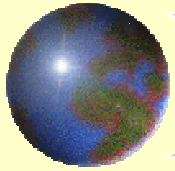
*IN BILLIONS. SOURCE: FORRESTER RESEARCH, MARCH 2000*



# ***E-COMMERCE Market Opportunity***

	<b><u>2000-2001</u></b>	<b><u>2004</u></b>
<b>Internet Penetration (Households)</b>		<b>65%</b>
<b>Business Generated</b>	<b>\$23 Billion</b>	<b>\$42 Billion</b>

**Source:Forrester Research and Quicken Insurance**

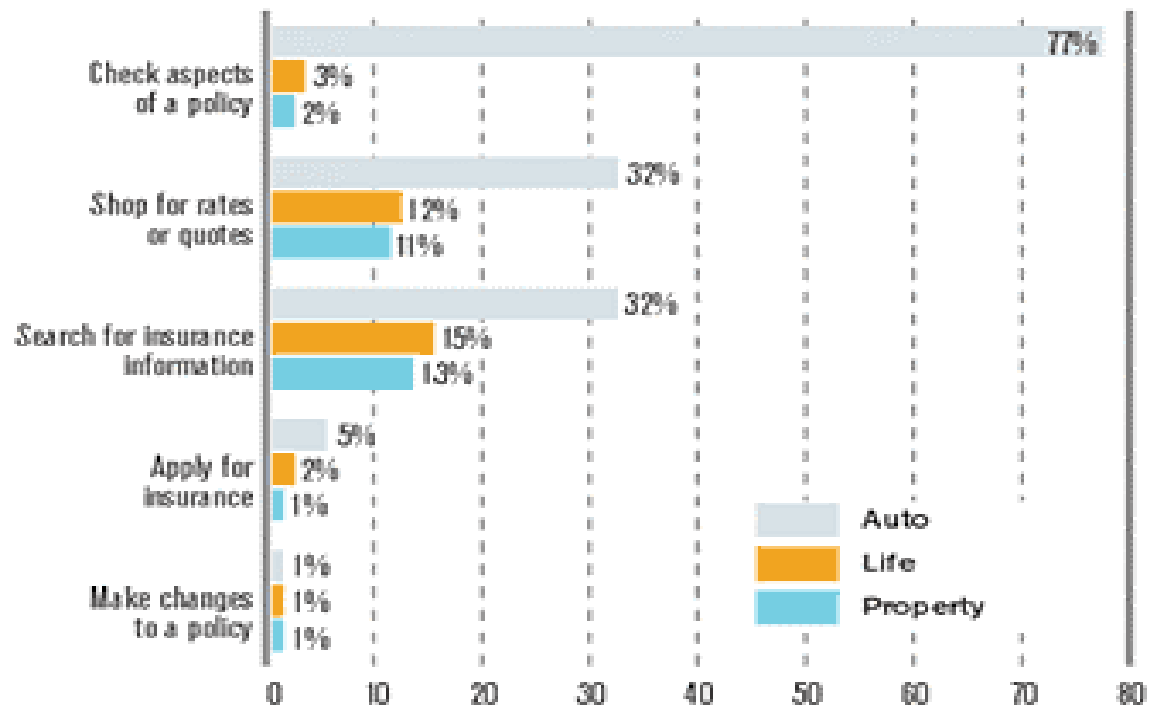


# ***E-COMMERCE***

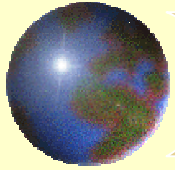
## ***Market Opportunity***

### **NET-SURFING DRIVERS COMPARISON SHOP**

**Online Activities of Insurance Policy Holders by Coverage Type**



*BASED ON SURVEYS OF U.S. AUTOMOBILE, LIFE OR PROPERTY INSURANCE POLICY HOLDERS WHO USE THE WEB. SOURCE: HARRIS INTERACTIVE, OCTOBER 2000*

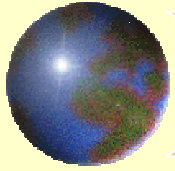


# ***E-COMMERCE***

## ***Market Opportunity***

### **Insurance Shopping Online**

- **42 percent of consumers who purchased insurance online listed comparison shopping as a big plus.** (Source: Data Monitor)
- **78 percent of consumers want their health insurer to be online and 37 percent are willing to switch carriers for that convenience.** (Source: Cyber Dialogue)

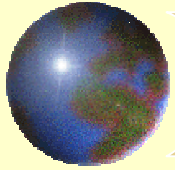


# **E-COMMERCE**

## **Market Opportunity**

**Nearly half of on-line consumers will research auto insurance on the Internet, and over a quarter are willing to buy on the Net now.**

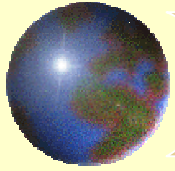
**Source: Forrester Research**



# ***E-COMMERCE Market Opportunity***

## **Commercial Lines**

	<b>1 YEAR</b>	<b>2 YEARS</b>
<b>Primary P&amp;C Coverage</b>	<b>49%</b>	<b>64%</b>
<b>Excess Coverage</b>	<b>45%</b>	<b>59%</b>
<b>Reinsurance</b>	<b>24%</b>	<b>38%</b>
<b>Alternative Risk Products</b>	<b>43%</b>	<b>52%</b>

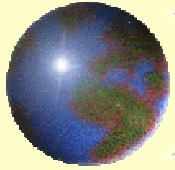


# ***NAIC ISSUES PAPER***

## ***Consumers***

- **Greatest areas of risk for consumers:**
  - 1) **Privacy** – not unique to E-Commerce
  - 2) **Fraud** – unauthorized insurers or scams
  - 3) **Quoting** – price is everything  
(accurate and fair comparisons – apples to apples).
  - 4) **Life Insurance Beneficiary changes.**

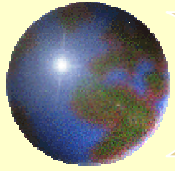
Source: Cap Gemini & Working Group



# ***NAIC ISSUES PAPER*** ***Electronic Commerce***

## ➤ **Broad Principles – Breaking Down Barriers**

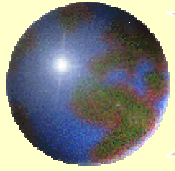
- 1) Uniformity**
- 2) Coordination with Federal Bills  
and National Model Acts**
- 3) Technology and Industry Neutrality  
(Flexibility & Level Playing Field)**



# ***NAIC ISSUES PAPER***

## ***Barriers to Electronic Commerce***

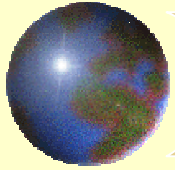
- **Countersignature Requirements**
- **Signatures and Electronic Authentication**
- **Records Retention**
- **Advertising**
- **Format**
- **Document Delivery**
- **Proof of Coverage**
- **Electronic Payment**
- **Disclaimers and Disclosures**
- **Jurisdiction**



# ***NAIC ISSUES PAPER***

## ***Barriers to Electronic Commerce***

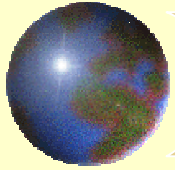
- **Countersignature Requirements**
  - ✓ **Should be eliminated**



# **NAIC ISSUES PAPER**

## **Barriers to Electronic Commerce**

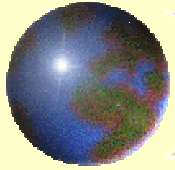
- **Written Signature Requirements**
  - ✓ **Working Group**
  - ✓ **Federal Legislation**
  - ✓ **UETA**



# **LEGISLATION REGARDING E-COMMERCE Federal Legislation**

## ➤ **Electronic signatures and records bill (S 761)**

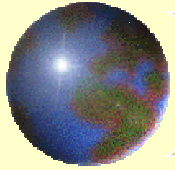
- ✓ **Passage:** June 16, 2000, Senate passes Conference Report (87-0)
- ✓ **Signed:** June 30, 2000, President signs.
- ✓ **Effective:** The Act is effective October 1, 2000. Record Retention effective March 1, 2001.



# ***LEGISLATION REGARDING E-COMMERCE Federal Legislation***

## **➤ E-Signature Definition: Same as UETA**

**An electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.**

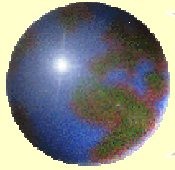


# **LEGISLATION REGARDING E-COMMERCE**

## ***Federal Legislation***

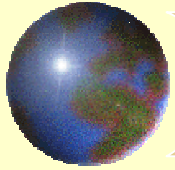
### **➤ General Rule:**

- ✓ **A signature, contract or other record relating to any transaction in or affecting interstate or foreign commerce may not be denied legal effect, validity, or enforceability solely because it is in electronic form.**
- ✓ **A contract relating to such transaction may not be denied legal effect, validity or enforceability solely because an electronic signature or electronic record was used in its formation.**



# ***LEGISLATION REGARDING E-COMMERCE Federal Legislation***

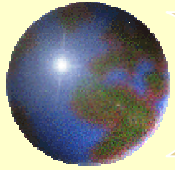
- **Procedures: allow the parties to decide:**
  - ✓ **Law does not require any person to use or accept electronic records or electronic signatures other than a governmental agency under certain provisions of the law.**



# ***LEGISLATION REGARDING E-COMMERCE Federal Legislation***

## **➤ Exclusions:**

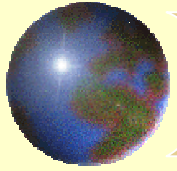
- ✓ Law adopts House Version
- ✓ The cancellation or termination of health insurance or benefits or life insurance benefits (excluding annuities).



# ***LEGISLATION REGARDING E-COMMERCE***

## ***Federal Legislation***

- **Preemption: House & Senate Versions**
  - ✓ **HR 1714's** electronic signature and records provisions do not apply where a state:
    - ✓ Adopts the Uniform Electronic Transactions Act (UETA), or
    - ✓ Specifies alternative procedures or requirements for the use or acceptance of electronic records or electronic signatures that are technology neutral.
  - ✓ **S 761** (pre-conference committee) did not preempt UETA states.



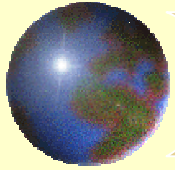
# **LEGISLATION REGARDING E-COMMERCE**

## ***Federal Legislation***

### ➤ **Intent**

- ✓ **S. 761, the Conference Committee Report directs the Secretary of Commerce to:**
  - ✓ **Promote the acceptance and use, on an international basis, of electronic signatures.**
  - ✓ **Take actions to eliminate or reduce, to the maximum extent possible, the impediments to commerce in electronic signatures for the purpose of facilitating the development of interstate and foreign commerce;**
  - ✓ **Items required to consider:**
    - **Paper based obstacles**
    - **Authentication technologies**
    - **Authentication in Legal Proceedings**

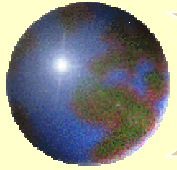
Source: S761 conference report



# ***UETA***

## ***Uniform Electronic Transactions Act***

- **Developed and released in July by the National Conference of Commissioners on Uniform State Laws**
  - ✓ **A record or signature may not be denied legal effect solely because it is in electronic form,**
  - ✓ **A contract may not be denied legal effect solely because an electronic record was used in its formation,**
  - ✓ **If a law requires a record to be in written form, an electronic record satisfies the law, and**
  - ✓ **If law requires a signature, an electronic signature satisfies the law.**

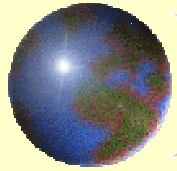


# ***UETA***

## ***Uniform Electronic Transactions Act***

### ➤ **Exceptions**

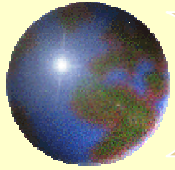
- ✓ **UETA allows states to enact exceptions to the general rule for consumer protection**
- ✓ **Federal Law:**
  - **Preempts UETA**
  - **Does not allow more exceptions**



# ***NAIC E-Commerce Bulletin***

## ***General Intent***

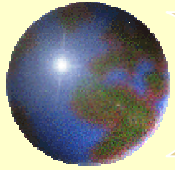
- Regulatory requirements are not designed to discriminate against any medium, but are designed to accomplish a particular regulatory objective, regardless of the medium used.
- When medium-specific references are contained in existing laws, the regulatory intent is to follow the objective of the law, rule or regulation, which may necessitate an interpretation of the existing law, rule or regulation to ensure that there is no discrimination of or against any particular media.



# ***NAIC E-Commerce Bulletin***

## ➤ **Signatures**

- ✓ **UETA (32 states).**
- ✓ **Electronic Signatures in Global and National Commerce Act (S761).**
- ✓ **Laws provide for legal recognition of electronic signatures and records.**



# ***NAIC E-Commerce Bulletin***

## **➤ Signatures—Federal Legislation**

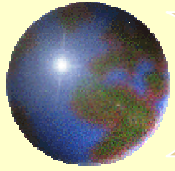
### **✓ Preemption**

- Any exception in a state law must be consistent with the federal law

### **✓ Exclusions**

- The cancellation or termination of health insurance or benefits or life insurance benefits (excluding annuities).
- Working Group – No exceptions at this point.

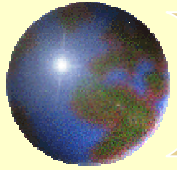
**Source: S761 conference report**



# **NAIC E-Commerce Bulletin**

## **➤ Records Retention**

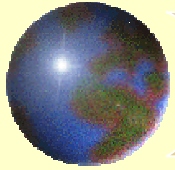
- ✓ Regulated entity must be able to reassemble the original information upon request.**
  
- ✓ If no paper copy, must be able to produce accurate record of communication between policyholder and the regulated entity.**



# ***NAIC E-Commerce Bulletin***

## **➤ Delivery**

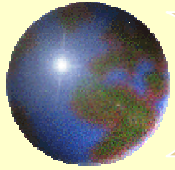
- ✓ E-Delivery and electronic communications permitted where agreed to by the parties involved.**
- ✓ Burden on regulated entity to meet all existing requirements for delivery.**
- ✓ Must be able to provide electronic or paper document to regulator or policyholder upon request.**



# ***NAIC E-Commerce Bulletin***

## **➤ Jurisdiction and Licensing**

- ✓ **Maintenance of a web site, where owner does nothing to purposely avail himself of the benefits of doing business in the jurisdiction, does not alone constitute “doing business” in a state.**
- ✓ **Operating a web site that includes insurance advertising does not constitute the transaction of insurance provided the operator does not solicit, sell or negotiate insurance.**
- ✓ **States will not assert jurisdiction if consumer are provided reasonable notice that advertised products are not available in the state.**



# ***NAIC E-Commerce Bulletin***

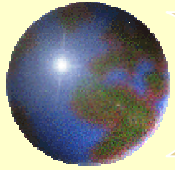
## **➤ Format**

### **✓ NAIC Issues Paper**

- Allow font type and size to be satisfied electronically by using clearly discernable and understandable characters.
- Font should be the same relative character sizes as rest of document.

### **✓ NAIC Bulletin**

- Requirement met if formatting designed to meet the same regulatory objectives as originally established for printed documents.



# ***NAIC E-Commerce Bulletin***

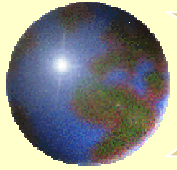
## **➤ Advertising**

### **✓ NAIC Issues Paper**

- **Reconsider filing and prior approval requirements to determine if such requirements are an inefficient use of scarce regulatory resources.**
- **Retrospective review of advertising through market conduct examination or other regulatory review processes.**

### **✓ NAIC Bulletin**

- **Advertising on web site subject to same rules as advertising in other media.**



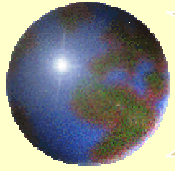
# ***FUTURE CHALLENGES***

## ➤ **Regulatory Enforcement**

- ✓ **Fraud Programs—Allocation of Resources**
- ✓ **Focus of enforcement actions—if and what will states focus on first?**
- ✓ **Compensation arrangements—should law be changed to take into account new marketing channels.**
- ✓ **Misrepresentations (examples: product features and quoting rates)**

## ➤ **Eliminate Barriers to E-commerce**

- ✓ **Implementation of Bulletin**
- ✓ **Identify other barriers to E-commerce**



## ***The Future***

- **The Internet is here to stay – good for industry and good for consumers.**
- **Industry will continue to respond to consumer demand.**
- **Regulators should foster an environment where E-Commerce will thrive globally.**

