



# UNITED STATES

## FINANCIAL SECTOR ASSESSMENT PROGRAM

April 2015

### DETAILED ASSESSMENT OF OBSERVANCE OF INSURANCE CORE PRINCIPLES

This Detailed Assessment of Observance of the Insurance Core Principles on the United States was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in March 2015.

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# UNITED STATES

## DETAILED ASSESSMENT OF OBSERVANCE

March 2015

### INSURANCE CORE PRINCIPLES

Prepared By  
**Monetary and Capital  
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in United States during October-November 2014, led by Aditya Narain, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

# CONTENTS

<b>GLOSSARY</b>	<b>3</b>
<b>EXECUTIVE SUMMARY</b>	<b>5</b>
<b>ASSESSMENT OF INSURANCE CORE PRINCIPLES</b>	<b>7</b>
A. Introduction and Scope	7
B. Information and Methodology Used for Assessment	7
C. Overview—Institutional and Macroprudential Setting	8
D. Preconditions for Effective Insurance Supervision	19
E. Recommendations and Authorities' Response	33
F. Authorities' Responses to the Assessment	37
<b>DETAILED ASSESSMENT</b>	<b>38</b>
<b>BOXES</b>	
1. Strengthening the U.S. Insurance Regulatory Architecture	12
<b>TABLES</b>	
1. Summary of Observance with the ICPs	22
2. Summary of Observance Level	33
3. Recommendations to Improve Observance of the ICPs	33
4. Detailed Assessment of Observance of the ICPs	38
<b>FIGURES</b>	
1. U.S. Insurance Companies—RBC Ratio	16
2. Asset Allocation (End of 2013)	18

## Glossary

ABCD	Actuarial Board for Counseling and Discipline
AICPA	American Institute of Certified Public Accountants
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
APPM	Accounting Practices and Procedures Manual
ASI	Annual Statement Instruction
ASOP	Actuarial Standards of Practice
ASB	Actuarial Standards Board
BHC	Bank Holding Company
BSA	Bank Secrecy Act
CCAR	Comprehensive Capital Analysis and Review
CFTC	Commodity Futures Trading Commission
CPA	Certified Public Accountant
CDS	Complaints Database System
CMG	Crisis Management Group
FAST	Financial Analysis Solvency Tools
FATF	Financial Action Task Force
FASB	Financial Accounting Standards Board
FAWG	Financial Analysis Working Group
FinCEN	Financial Crimes Enforcement Network
FINRA	Financial Industry Regulatory Authority
FIO	Federal Insurance Office
FDIC	Federal Deposit Insurance Corporation
FRB	Federal Reserve Board
FSOC	Financial Stability Oversight Council
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GLBA	Gramm-Leach-Bliley Act
GWP	Gross Written Premium
HOLA	Home Owner's Loan Act
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principle
IFRS	International Financial Reporting Standards
IGT	Intra-Group Transactions
IRS	Internal Revenue Service
LEO	Law Enforcement On-Line
LISCC	Large Institution Supervision Coordinating Committee
IIPRC	Interstate Insurance Product Regulation Commission
MAWG	Market Analysis Working Group
MISCA	Master Information-Sharing and Confidentiality Agreement
MoU	Memorandum of Understanding

## UNITED STATES

NAIC	National Association of Insurance Commissioners
NARAB	National Association of Registered Agents and Brokers
NASDAQ	National Association of Securities Dealers Automatic Quotation System
NBFC	Non-bank Financial Company
NIPR	National Insurance Producer Registry
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OFR	Office of Financial Research
ORSA	Own Risk and Solvency Assessment
PBR	Principle-Based Reserving
PCAOB	Public Company Accounting Oversight Board
RIRS	Regulatory Information Retrieval System
RBC	Risk-Based Capital
RRG	Risk Retention Groups
SAO	Statement of Actuarial Opinion
SAP	Statutory Accounting Principles
SAD	Special Activities Database
SEC	Securities and Exchange Commission
SLHC	Saving and Loan Holding Company
SMI	Solvency Modernization Initiative
SVL	Standard Valuation Law
SVO	Securities Valuation Office
TAC	Total Adjusted Capital
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TRIP	Terrorism Risk Insurance Program
UCAA	Uniform Certificate of Authority Application

## EXECUTIVE SUMMARY

**U.S. insurance supervision has been significantly strengthened in recent years.** Lessons have been learned from the financial crisis and many of the recommendations of the 2010 FSAP are being addressed. Insurance has been brought within the scope of system-wide oversight of the financial sector. The establishment of the Federal Insurance Office (FIO) has created a mechanism for identifying national priorities for reform and development. The extension of the Federal Reserve Board's responsibilities to cover consolidated supervision of insurance groups has strengthened supervision of the affected groups (now covering around 30 percent of total premium income in the United States) and promises to empower U.S. regulators in the negotiation and implementation of new international standards of insurance regulation. State regulators have been adjusting to the new regulatory architecture, at the same time progressing important reforms such as the solvency modernization initiative and significantly strengthening group and international supervision.

**Many of these changes are still a work in progress.** At the state level, the transition from a strongly rules-based approach to more principles-based regulation and risk-focused supervision is progressing but is taking time and faces obstacles. Increased emphasis is being placed on risk management through the introduction from 2015 of an Own Risk and Solvency Assessment (ORSA) with wide-ranging implications for supervisory work and resourcing. The FRB's supervisory approach to insurance groups has benefited from its experience of banking supervision, but still needs to strike out in its own direction; and the development of FRB regulation is proceeding slowly. Staffing both regulation and supervision with appropriate skills and expertise is continuing.

### **Overall, the assessment finds a reasonable level of observance of the Insurance Core**

**Principles.** There are many areas of strength, including at state level the powerful capacity for financial analysis with peer group review and challenge through the processes of the National Association of Insurance Commissioners (NAIC). Lead state regulation is developing and a network of international supervisory colleges has been put in place. Regulation benefits from a sophisticated approach to legal entity capital adequacy (the Risk-Based Capital approach). Regulation and supervision continue to be conducted with a high degree of transparency and accountability. FRB supervision is bringing an enhanced supervisory focus to group-wide governance and risk management. Cooperation between state and federal regulators is developing, based on the complementarity of their approaches, although it has further to go.

**Key areas for development include the valuation standard of the state regulators, especially for life insurance, and group capital standards.** The standard for valuation of assets and liabilities has developed over many years. For life insurers, it is prescriptive and in many cases formula-based. As products have become more complex, the prescribed algorithms and formulae used to determine reserves have grown in complexity. The standard has varying levels of conservatism, which leads to a lack of transparency. It does not give an incentive for appropriate dynamic hedging. Its shortcomings are circumvented and mitigated by complex structures that life insurers put in place, including transactions with affiliated captive reinsurers. The standard should be changed to reflect the economics of the products better. Principles-Based Reserving, part of the solvency

modernization initiative, would mitigate some of the issues, but its implementation date is uncertain. In relation to capital, there are no group-level capital standards in place for groups, whether supervised by states or the FRB. States should have the ability to set group-wide valuation and capital requirements, while the FRB should develop a valuation and capital standard speedily. RBC should be extended to financial guaranty companies, responding to the experience with this sector in the financial crisis.

**There are also gaps in governance and risk management requirements and in market conduct and intermediary supervision.** Neither state nor FRB supervisors have set insurance-specific governance requirements that would hold boards responsible for a governance and controls framework that recognizes and protects the interests of policyholders. There are no requirements for risk management and compliance functions, although state insurance regulators will require larger companies to have internal audit functions from next year. An increasing focus on governance and controls in supervision by both states and FRB mitigates the effect of the gap in regulation. However, state examinations normally take place only every five years (FRB examinations are more frequent, if not continuous). More frequent state examinations of larger companies and reduced reliance on outsourcing of the work in some states should be considered. Market conduct supervision, which is carried out only by the states, should be strengthened through a risk-focused supervisory framework, enhanced analysis of risk (including those due to complex products and commission-based sales) and supervision of the more significant intermediaries.

**There is a need to review governance and funding arrangements for state insurance regulators.** The arrangements for appointment and dismissal of commissioners in many states expose supervision to potential political influence. The high dependence on state legislatures in respect of legislation and resources exposes supervisors both to political influence and to budgetary pressures. These risks are mitigated but not eliminated by NAIC processes. There is also a need to review levels of skills and expertise, as the technical demands of supervisory work change in line with regulatory reforms including ORSA and possible Principles-Based Reserving.

**The objectives of state regulators and scope for conflict between FRB objectives and policyholder protection should be reviewed.** State regulators' objectives are not clearly and consistently defined in law. The FRB's objectives in relation to insurance consolidated supervision do not include insurance policyholder protection and there is potential for conflict, in times of stress, between the expressed objectives of the regulation of savings and loan holding companies and non-bank financial companies, and the interests of insurance policyholders.

**While recent reforms are bringing benefits, the regulatory system for insurance remains complex and fragmented and reform should be considered to address the resulting risks.** There are differences between state insurance regulators and between state and federal regulators, in both regulation and supervision. The regulatory system is complex and there are risks from a lack of consistency, including the creation of opportunities for unhealthy arbitrage (which accounts in part for the growing use of affiliated captive reinsurers, for example); and risks of failure to act on gaps or weaknesses in regulation with sector or system-wide implications. The current regulatory architecture lacks capacity to fully address these issues. The authorities should review the options for

change, which include strengthening the capacity of the FIO to bring about convergence on uniform high standards of regulation and supervision as well as comprehensive market oversight.

## ASSESSMENT OF INSURANCE CORE PRINCIPLES

### A. Introduction and Scope

1. **This assessment of insurance regulation in the United States of America was carried out as part of the 2014–15 U.S. Financial Sector Assessment Program (FSAP).** It was conducted by Ian Tower, Philipp Keller (both external experts engaged by the IMF) and Nobuyasu Sugimoto (IMF Expert) from October 27 to November 17, 2014.
2. **The current assessment has been made against the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in October 2011, as revised in October 2013.**<sup>1</sup> The previous assessment, in 2010, was conducted on the observance with an earlier version of the ICPs issued by the IAIS in 2003. The ICPs apply to all insurers, whether private or government-controlled. Specific principles apply to the supervision of intermediaries. The institutional arrangements for financial sector regulation and supervision are outlined in Section C.

### B. Information and Methodology Used for Assessment

3. **The level of observance for each ICP reflects the assessment of its standards.** Each ICP is rated in terms of the level of observance as follows:
  - a) **Observed:** where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and exercises this authority to a satisfactory level.
  - b) **Largely observed:** where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
  - c) **Partly observed:** where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
  - d) **Not observed:** where no substantive progress toward observance has been achieved.
4. **The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment in November 2014.** While this assessment does not reflect new and on-going regulatory initiatives, key proposals for reforms are summarized by way of additional comments in this report. The authorities provided a

<sup>1</sup> The 2014-15 USA FSAP also includes a Technical Note discussing the alignment of the insurance sector resolution regime to the FSB's Key Attributes of Effective Resolution. While there is some overlap in coverage between the ICPs and the Key Attributes, the substantive requirements of the two standards are not equivalent with regard to recovery and resolution issues. Accordingly, the conclusions on these issues set out in this assessment may differ from those reached in the separate Key Attributes technical note.



full and well-written self-assessment, supported by anonymized examples of actual supervisory practices and assessments, which enhanced the robustness of the assessment.

**5. The assessment addresses insurance regulation nationally and does not assess individual state authorities.** The principal regulatory responsibilities are shared by the 50 states, the District of Columbia and five U.S. territories (hereinafter “states” includes the 50 states, the District of Columbia and five U.S. territories, unless the latter two are specifically mentioned), the Federal Reserve Board (in respect of consolidated supervision only) and the FIO. Technical discussions with officials from federal agencies and bodies (FIO, FRB, FSOC, FinCEN), NAIC and two sample state insurance departments (those of the states of New York and Massachusetts), and the independent member with insurance expertise of the FSOC also enriched this report; as did discussions with industry participants. As the assessment addresses national compliance and the assessors were not able to hold discussions or review material from more than a few state authorities (and a selection of Federal Reserve banks), reliance has also been placed on the processes and procedures used by the NAIC (i.e., the commissioners of insurance acting collectively and the staff of the association) in their support for state regulators.

**6. The assessors are grateful to the authorities and private sector participants for their cooperation.** The assessors benefitted greatly from the valuable inputs and insightful views from meetings with federal and state agencies, insurance companies and industry and professional organizations.

## C. Overview—Institutional and Macroprudential Setting

### Institutional Framework and Arrangements

**7. Insurance regulation and supervision is a shared responsibility of federal and state authorities.** States are responsible for licensing, supervision and examination of all insurance companies and intermediaries (known in the United States as “producers”). As part of the U.S. response to the 2008 financial crisis, the FRB’s responsibilities for consolidated supervision of groups which include insurance companies have been extended to relevant designated non-bank financial groups (NBFCs) and savings and loan holding company groups (SLHCs). Its responsibilities now cover around 30 percent of total premium income in the United States. A new Federal Insurance Office (FIO) has, amongst other responsibilities, a broad monitoring role for the insurance sector and its regulation. Other bodies, both, state and federal, have a role in aspects of insurance regulation, including the FSOC (in relation to designation of NBFCs and identification of risks to financial stability), state securities regulators and the SEC (and FINRA) in relation to products and practices covered by securities laws; the Department of Labor in relation to workplace pension products; and FinCEN and the IRS in relation to AML/CFT regulation and supervision.

**8. States generally carry out insurance regulatory functions through insurance departments of the state administration.** The insurance departments carry out licensing, supervision and examination work for insurance companies and intermediaries under powers set out in state legislation and in accordance with state budgets. A commissioner heads the department and

exercises all formal powers. Some commissioners are elected, but most are appointed by the state governor. While arrangements vary among states, funding is usually raised from the insurance markets via fees and levies. Insurance departments' budgets are generally subject to the state budgeting processes. Insurance departments also collect premium taxes for the states, a significant part of state governments' total revenues.

**9. The National Association of Insurance Commissioners (NAIC) plays an important role in promoting consistency across state regulation.** NAIC is a regulatory support organization for state insurance supervision. Through the NAIC, state regulators establish model laws, regulations, best practices, and examination handbooks, and coordinate their regulatory oversight. NAIC has around 470 staff, which compares with 11,529 employed by the states. NAIC staff provides technical support (such as IT and financial analysis). Key functions of the NAIC are:

- Processes and procedures to develop and agree on model laws and regulations, which now total over 200. States develop these laws via NAIC working groups. While states are not obliged to implement model laws and regulations in state law, the process creates an expectation that state legislation will broadly mirror the requirements agreed by commissioners at NAIC meetings. In practice, states often implement the models with variations, but the primary objectives are consistent from state to state.
- The Financial Regulation Standards and Accreditation Program (referred to in this report as “the accreditation program”) is a process that develops certain minimum standards in respect to financial regulation of multistate companies (i.e. the standards do not cover companies that operate in only the “state of domicile”) and reviews state insurance departments for compliance with those standards. It covers, in relation to financial issues, laws and regulations and key provisions on accounting and solvency; regulatory practices, including offsite and onsite supervision; and organizational and staffing practices. Standards on insurance company licensing were added in 2012. In order to achieve and retain accreditation, states undergo a detailed review by independent examiners (many are accountants or retired senior regulators) once every five years; interim annual reviews are also required. Final decisions on accreditation are taken by a committee of commissioners. All 50 states, the District of Columbia and Puerto Rico are accredited. Formally, the effect of accreditation is to enable states to rely on the solvency regulation undertaken by the domestic state rather than carrying out their own, although individual states may still impose additional requirements on “foreign” companies (i.e., accreditation does not guarantee reciprocity). There are also reputational implications.
- The centralized process of financial analysis operated through the mechanism of the NAIC's Financial Analysis Working Group (FAWG). This is a group of 18 senior financial experts who meet to discuss reports from NAIC staff covering all “nationally significant companies” (around 1,600 companies representing 85 percent of the market) based on annual and quarterly statements and other information. The objective is to challenge domestic state regulators, who retain responsibility for any action, on their analysis of companies and their regulatory response. A similar process has been developed for market conduct regulation.

- The provision of a number of databases covering financial information (most companies submit statements direct to the NAIC), data on producers, etc., and support for technical financial analysis. For example, the Capital Markets Bureau of the NAIC monitors developments, trends and activity in the financial markets generally, and specifically with respect to the insurance industry. Issues that are of interest to state insurance regulators are reported periodically through regular publications and through ad hoc reports. It also conducts independent research on investment issues and responds to requests from state insurance regulators. It assists in examinations, through analysis of investment portfolios, discussions with examiners and, as requested, participates in on-site examinations.

**10. State regulators have been enhancing their approach to financial regulation in recent years.** In 2008, the NAIC launched the Solvency Modernization Initiative (SMI), a review of financial requirements and are implementing a number of key reforms, some of which also reflect the recommendations of the 2010 FSAP, including:

- Adoption of revised group supervision requirements: the revised Insurance Holding Company System Regulatory Act (Model #440) and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (Model #450).
- Adoption of the Risk Management and Own Risk and Solvency Assessment Model Act (#505) and the Own Risk and Solvency Assessment (ORSA) Guidance Manual.
- Increased scheduling of supervisory colleges and implementation of supervisory colleges' tracking documentation, an increase in MoUs between state regulators and international regulators.
- Adoption of requirements on companies to report to regulators on the details of their corporate governance.
- Adoption of revised requirements regarding within the Credit for Reinsurance Model Law (Model #785).
- NAIC adoption of updates to the Standard Valuation Law (Model #820) and the Standard Nonforfeiture law for Life Insurance (Model #808), completion of the industry impact study for life insurance principles-based reserving, and adoption of the Valuation Manual. Over the past several years there has been much discussion about how the current rule-based reserve requirements create redundant reserves for some products and inadequate reserves for others. The generally agreed solution is to move from a rule-based approach to a principle-based approach. This would allow insurance valuation to move toward more principles-based reserving in life insurance; and consideration of making capital requirements reflect individual company risk characteristics more (see assessment of ICP14).

- Amended RBC requirements to require capital to be held for cash collateral reinvested under securities lending requirements—requiring such investments to be treated as on the balance sheet and subject to RBC charges.

**11. However, other issues highlighted by the financial crisis have not been fully addressed.**

Reforms are pending to the requirements applying to financial guaranty (bond insurers—also referred to as monoline insurers). Private mortgage insurance companies are not subject to RBC, although NAIC and state regulators are working on such changes. Most importantly, group capital requirements have not been implemented either by federal or state regulators as yet.

**12. The FRB has responsibility for consolidated supervision of certain groups (17 in total) containing insurance companies.** The FRB has no authority to license or regulate individual insurance companies, but has a role in insurance regulation and supervision through its primary federal responsibility for consolidated regulation of:

- bank holding companies under the Bank Holding Company Act (BHC Act)—to the extent that there are one or more insurance companies as well as at least one bank in the group (there are no such groups at present);
- savings and loan holding companies (SLHCs) under the Home Owners' Loan Act (HOLA) (to the extent that are one or more insurance companies as well as at least one savings and loan company in the group—there are 15 such groups at present, including four of the largest insurers in the country); and
- insurance companies which are non-bank financial companies (NBFCs) under the Dodd-Frank Act, where the company has been designated for FRB supervision by the FSOC (there are two insurance groups at present, AIG and Prudential Financial).

**13. The FRB's approach to its new responsibilities is developing.** The FRB has been growing its staff in the insurance area, drawing on staff from other FRB functions, including banking supervision, from state insurance departments and from the insurance sector. Currently, there are more than 70 full time employees, many with insurance and supervision expertise that contribute to overseeing the (approximately) 17 insurance companies under Federal Reserve supervision. This process is on-going, in terms of numbers and expertise, including actuarial. The FRB's regulatory regime is also still developing and it has not yet defined a group level capital requirement for insurance groups it regulates. The application by the FRB of a supervisory approach developed for large banks has, however, led to intensified supervisory work on group-wide governance and risk management issues at FRB-supervised groups.

**14. In addition, the FIO has been established in the Treasury Department and has made a number of recommendations on insurance regulation and supervision.** While it has no authority to license or regulate individual insurance companies or to undertake consolidated supervision, under the Dodd-Frank Act FIO has a broad monitoring role for the insurance sector and its regulation, a lead role in international aspects of insurance regulation and specific responsibilities in

relation to systemic risk in the insurance sector. In December 2013, it released a “Modernization Report” pursuant to title V of the Dodd-Frank Act, and provided 18 near-term recommendations to the state regulators, nine recommendations on direct federal involvement and proposed potential federal solutions for the long term. Some of the recommendations relate to areas that were the subject of various NAIC workstreams before the report was published.

**15. Although reforms have brought benefits, the regulatory system for insurance is complex and fragmented and reform should be considered to address the resulting risks.**

Reforms of the regulatory architecture under Dodd-Frank have brought improved mechanisms for addressing risks to stability in the insurance sector as well as stronger consolidated supervision and other benefits. However, complexity and fragmentation bring risks of a lack of consistency and of failure to act on gaps or weaknesses in regulation with sector or system-wide implications. Box 1 explores options for reform to the regulatory architecture that might address these risks.

**Box 1. Strengthening the U.S. Insurance Regulatory Architecture**

**This assessment has identified differences and inconsistencies between state insurance regulators and between state and federal regulators, in both regulation and supervision.** The regulatory system is complex and there is scope for conflict between the mandates of the different agencies. There are risks from a lack of consistency, including the creation of opportunities for unhealthy arbitrage (which accounts in part for the growing use of affiliate captives and which appears to influence companies’ choice of states in which to incorporate); and risks of failure to act on gaps or weaknesses in regulation with sector or system-wide implications.

**The current regulatory architecture lacks capacity to fully address these issues.** The NAIC continues to promote uniform standards of state regulation, through model laws and the states accreditation program that includes most solvency laws. However, the NAIC cannot enforce convergence. One of FIO’s objectives is to monitor all aspects of the insurance sector, including identifying issues or gaps in the regulation of insurers. However, FIO can only highlight issues and it too lacks powers to bring about convergence. The extension of the FRB’s powers to insurance supervision of NBFCs and some other groups, while valuable in strengthening insurance consolidated supervision, has added to the challenges of achieving regulatory consistency (for example in holding company regulation and approaches to capital adequacy). FSOC brings together most of the players, but its mandate is focused on system-wide stability and its membership does not provide for sector-wide coverage of insurance on the same basis as other sectors.

**Many of the approaches to insurance regulatory reform proposed over recent years could help address these issues, although with differing costs and implications.** While extensive reform, including an optional federal charter, was canvassed before the financial crisis, the changes made by the Dodd-Frank Act in insurance regulation were relatively limited. Changes that would deliver greater consistency could be undertaken at state or federal level or both, such as:

- The states could strengthen their commitment to convergence on high standards and the mechanisms to deliver them, including relying on the work performed and shared with the states by the FRB.
- Federal regulation of insurance could be broadened to cover direct financial regulation of either all or at least the larger insurance companies; or there could be a “dual mandate” system, as for banks.
- The federal government could coordinate the establishment of national standards for insurance regulation, to be implemented by states and the FRB, or could set such standards directly.
- A new agency, at the national level, with appropriate independence and expertise, could be created with a mandate and powers to deliver consistency and coordination.
- The existing accreditation program could be strengthened and extended, for example with an independent

panel appointed under appropriate processes by Commissioners and FRB.

None of these changes would be sure to deliver on the objectives of consistency and high standards (across state and federal regulation and supervision) without risks of introducing inefficiencies or significant transitional costs, including a loss of expert insurance supervisory staff (most of whom are at the state level at present). Implemented with appropriate safeguards, however, they should deliver significant change.

**Another feasible option, building on Dodd-Frank, would be to assign the needed responsibilities and authority to the FIO.** The FIO already has a broad monitoring mandate. This could be extended to give FIO:

- a lead role in accrediting insurance regulators, both state and federal, in line with (but with greater independence than) the current accreditation program at the NAIC. The process would need to focus on the effectiveness of regulation and supervision, not only whether relevant laws and processes are in place, and be conducted with a high degree of transparency in process and results;
- a lead role in collating sector-wide data and analyzing risks in the insurance sector; and
- potentially also a role in establishing national standards - extending its existing powers to pre-empt state regulations, which are currently limited to the field of international agreements on prudential matters.

**Such extended responsibilities for FIO would work only if accompanied by making the FIO operationally independent from the government.** Currently an office within the Department of Treasury, FIO would need appropriate powers, sufficient resources, accountability and independence from undue political and industry pressure in line with the expectations of the Insurance Core Principles.

**The contribution which the NAIC already makes to the objectives of more consistent regulation and better market oversight should also be recognized in this context.** Extensive expertise has been developed in insurance regulation and market oversight by the NAIC in its current role and status as a consensus-based association of insurance commissioners. It will be important to ensure that its expertise and processes are engaged in any institutional change to deliver more consistent regulation.

### **Guaranty Funds (policyholder compensation arrangements)**

**16. Insurance policyholders are protected against loss due to the insolvency of insurance companies by guaranty associations in each state.** All U.S. insurance companies are required to be members of associations covering life and health insurance and, through separate organizations, property and casualty. These associations are established by state laws (NAIC-developed Guaranty Association Model Acts). Payments are triggered by the insolvency of an insurer, although, in practice, associations seek to obtain continuity of coverage by transferring policies to other companies. Laws differ on the extent of coverage and maximum amount payable per policyholder among states (between US\$100,000 to US\$500,000 depending on the product and state). Associations rely on assessments of other insurers writing the same class of business in order to make payments to policyholders, i.e., they are not pre-funded. State laws set limits on assessments—typically, for life insurance, 2 percent of each insurer’s prior year premium income in the state per year.

## Market Structure and Industry Performance

### *Industry Structure and Recent Trends*

**17. The U.S. insurance market is the largest in the world.** There were 4,538 insurance companies reporting to the NAIC at the end of 2013.<sup>2</sup> Total premium volume in 2013 of US\$1.56 trillion accounted for 33 percent of the global market (Japan and the United Kingdom were second and third largest with 11 percent and 7 percent shares respectively). On insurance density measures (premiums per capita), the United States ranked eleventh at US\$3,979 in 2013 and seventeenth on insurance penetration (premiums as a percentage of GDP) at 7.5 percent.<sup>3</sup> There are three main sectors—life, property and casualty (divided between personal and commercial lines), and health insurance. Key specialist insurance lines (i.e., those which must be written in separate companies) are: financial guaranty; mortgage insurance<sup>4</sup>; and title insurance.

**18. Most U.S. insurers write primary insurance on U.S. risks.** The U.S. market is characterized by:

- relatively low market concentration in most sectors. Top 10 insurers account for 58 percent (in life), 71 percent (in health) and 46 percent (in P&C), which are lower than those of other developed jurisdictions;
- limited private sector capacity in certain “hard to insure” risks, particularly those related to severe weather, natural catastrophes, and some classes of medical risks, which has led to the creation of certain “residual market” mechanisms, such as joint underwriting arrangements and programs provided directly by state or federal government; at federal level, these cover, in particular, terrorism losses (TRIP), flood risk and crop loss; and, at state level, mainly workers compensation or property risks in areas exposed to natural catastrophes and reinsurance for hurricane losses (the Florida Hurricane Catastrophe Fund); and
- a limited number of foreign owned insurance groups. Most of the large insurance groups are domestically owned with a few exceptions (such as Jackson National owned by UK Prudential, Transamerica owned by AEGON, AXA Equitable and John Hancock owned by Manulife). Although there are internationally active insurance groups, most business written by U.S. insurers is in relation to U.S. risks; and
- no large conglomerate groups offering both banking and insurance services: there are only four large insurance groups (TIAA-CREF, State Farm Mutual, Nationwide Mutual and USAA)

<sup>2</sup> The figures do not include the entities which are not required to file to the NAIC, such as reinsurers, captives and SPVs.

<sup>3</sup> All data on the U.S. (except premiums) are from NAIC and other data are from Swiss Re: World Insurance in 2013.

<sup>4</sup> Gross premium written by financial guaranty insurers and mortgage insurers were US\$1,258 million and US\$5,107 million respectively in 2013.

which have deposit-taking institutions and material insurance activities. These are regulated by the Federal Reserve Board as saving & loan holding companies (SLHCs).

**19. Large life insurance groups have expanded non-traditional insurance business (separate account) and provide complex guarantees.** Since 2002, separate account business has grown by 8 percent annually on average, while general account business grew by 4 percent annually, and reached over US\$2 trillion in total assets. Although the investment risks fall to policyholders, in practice insurers typically provide (often complex) guarantees, such as Guaranteed Lifetime Withdrawal Benefit, to policyholders. The industry has improved the management of the exposures created by these guarantees by changing product designs and by using dynamic hedging strategies. However, the effectiveness of their risk management in case of market turmoil remains uncertain.

**20. While nationwide data is not available at the time of the assessment, distribution of insurance products is mainly through agents and brokers.** Bancassurance is allowed and banks do distribute insurance products but they have limited market share. Intermediaries distributing insurance (collectively known as producers) act as agents of one or more insurance companies (captive agents or independent agents) or as brokers—i.e., acting on behalf of the customer.

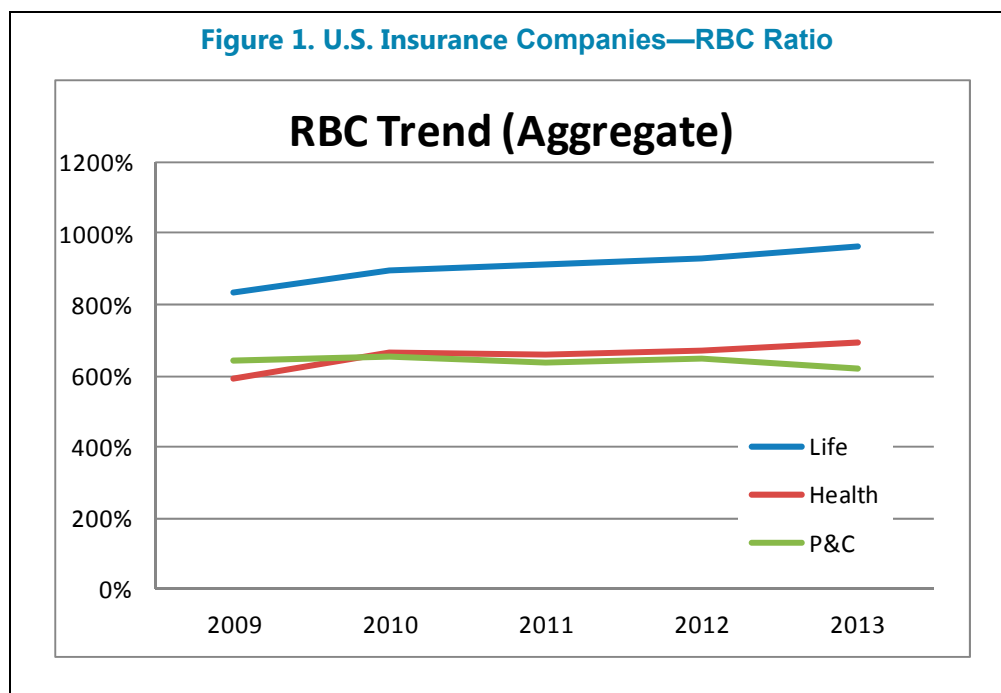
**21. The insurance sector has been gradually improving its capital position in recent years.** Capital adequacy at legal entity level, measured by the regulators' risk-based capital (RBC) requirements, has improved since the global financial crisis, as has the number of companies breaching regulatory intervention levels. While there have been several firms placed in receivership, only one company was subject to receivership for causes directly related to the financial crisis. The RBC ratio of property and casualty sector slightly decreased in 2013 but remains high (Figure 1).<sup>5 6</sup>

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<sup>5</sup> Insurers are required to include catastrophe risk charges for earthquake and hurricane in their RBC calculation at present for informational purposes. After further testing is complete, these charges will become part of the calculation of capital requirements. Had these catastrophe charges been in effect in 2013, it would have resulted in a slight decrease in the actual average RBC ratio from 669 percent to 636 percent.

<sup>6</sup> As the confidence levels which are used to calibrate for RBC factors and implicit margin included in the statutory reserves are different among life, health and P&C, it is difficult to compare capital adequacy among those three sectors.





**22. However, a number of firms remain in stressed condition.** More than 100 firms have exited the market every year since 2008,<sup>7</sup> while the number of new entries are about half of the exits. Although most of the firms exit the market voluntarily, a small number of firms failed (because of financial impairment) every year. There are number of insurers which have triggered regulatory actions because of low levels of capital. As of the end of 2013, 11 life, 1 fraternal, 39 health and 11 P&C insurers were under intensive monitoring.

**23. Capital adequacy ratios are hard to interpret due to the basis of valuation and the complexity of the insurance business.** Insurance liabilities and corresponding assets are generally measured on an amortized cost basis and large unrealized losses may remain on both sides of the balance sheet, unless the assets are other than temporarily impaired. Regulators have allowed some individual modification (“permitted practices”) to firms to increase their capital position, but the use of such practices in recent years has been limited as to both the number of companies with such practices and the impact across the industry. US life insurers have been active in providing complex products (variable annuity and universal life) with guarantees that can be challenging to manage. Large transactions have been undertaken by large insurance groups to increase their solo level capital position by creating captive reinsurance companies into which they reinsure their risk. Some transactions (especially term insurance policies) are driven by a strategy of avoidance of conservative mortality assumptions for reserving required by state regulators, which is not the case for variable annuity products and universal life products with guarantees.

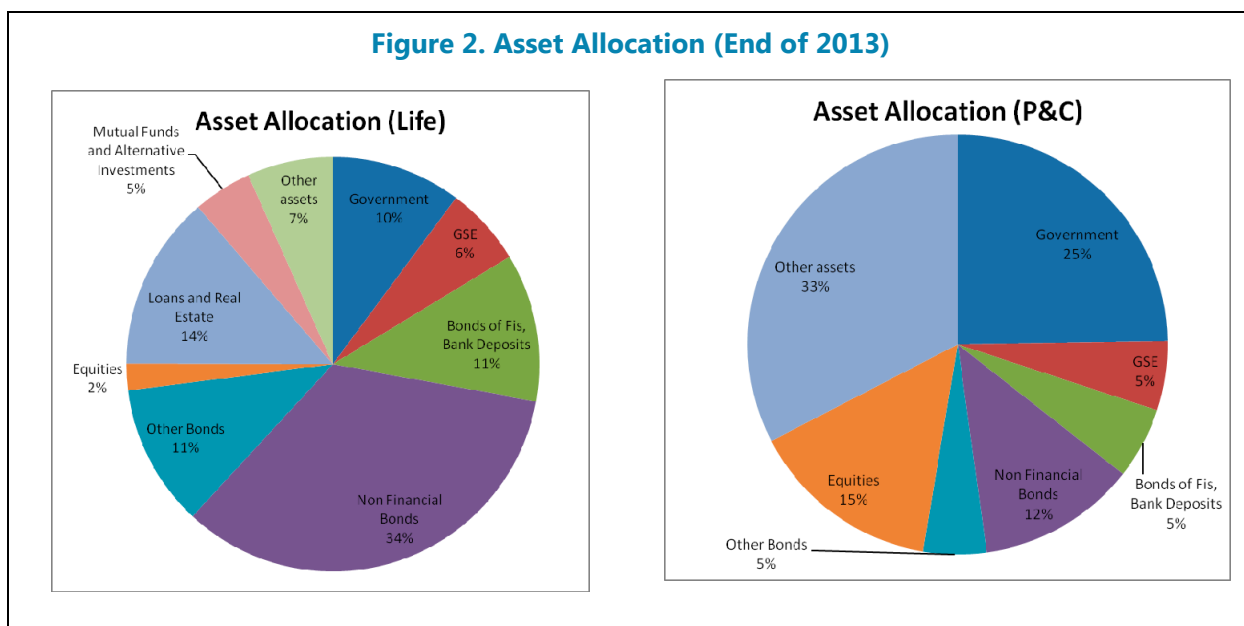
<sup>7</sup> The number of exits of insurers was 147 in 2008, 213 in 2009, 182 in 2010, 142 in 2011, 157 in 2012 and 130 in 2013.

**24. Regulatory capital adequacy measures at group level are not available, which hampers assessment of the overall soundness of the US insurance sector.** While two insurance groups are designated as nonbank financial companies (NBFCs) and are subject to group wide supervision by the FRB, group wide capital requirements have not been developed yet. Intra group transactions are subject to reporting to the state regulator, but reporting and approval requirements are uneven among various states, which may be a source of arbitrage opportunities and create significant contagion risks among group entities. Active usage of affiliate captives (not uniformly subject to RBC in all states and not always subject to full disclosure requirements) creates uncertainty whether capital adequacy is sufficient at the group level.

**25. U.S. insurers have been gradually increasing investment in more risky and illiquid assets and equities in recent years, although totals of such investments remain low and capital and investment regulations work to prevent excessive risk taking.** Such investment includes private equity, hedge funds, longer duration and lower credit corporate bonds, and real estate related assets. Equity investment by P&C companies has reached nearly 20 percent of total assets. Life insurers are increasing their asset allocation into lower grade and longer-term corporate bonds. Some life insurers are increasing their securities lending activities and the cash collateral has been reinvested. However, as noted above, statutory accounting and capital requirements have been amended since the financial crisis so that collateral which insurers can re-use must be treated as on-balance sheet and collateral reinvestment is subject to a capital charge. In addition, investment limits (10 percent of capital resources) on securities lending have been introduced. Annuity providers are struggling to manage their hedging portfolio as the embedded options in annuity products are difficult to replicate with standardized derivatives and insurers need to rebalance the hedging portfolio continuously through dynamic hedging, with a significant impact on their earnings in recent quarters.

### Assets and liabilities

**26. The life insurance sector has significant allocation to corporate bonds with long maturities, while the P&C insurance sector has material allocation to equity.** In the life sector, more than 30 percent of investment is in non-financial corporate bonds (34 percent), followed by other bonds (11.1 percent), government bonds (10.2 percent), mortgage loans (9.6 percent) and bonds of financial institutions (9 percent). Fifty percent of government bonds and 30 percent of corporate bonds are invested into long term (more than 10 years as of the end 2012). The P&C sector has material allocation to equity (15 percent), government bonds (25 percent) and municipal securities that have been included as other assets in the chart below.

**Figure 2. Asset Allocation (End of 2013)**

**27. Technical provisions account for the majority of liabilities, which are generally well diversified, with low liquidity risks, and the main products are annuities for life and liability insurance for P&C.** In the life sector, 90 percent of liabilities are from technical provisions and 65 percent<sup>8</sup> of the technical provisions are from annuity business (as of the end 2012). In P&C sector, 57 percent is from technical provisions but other liabilities also have large share (42 percent), in part because they include accounting for unearned premiums.

### Key risks and vulnerabilities

**28. While pressures have eased, there remain challenges.** The key risks and vulnerabilities are as follows.

- Life companies in particular remain exposed to significant risk if economic growth falters again. Their commercial property exposure is high (while it is still below the peak before the financial crisis), both in loans and investments, as is exposure to banks. A further-prolonged low interest rate environment would exacerbate strains. While life insurers are extending the duration of their investments, longevity may increase the duration of the liability side in the future, which may exacerbate the impact of ALM mismatches and the vulnerability to low interest rates. This is critical given the predominance of annuity business in technical provisions of life insurers.
- Property and casualty risks are more dispersed. The United States is exposed to major natural catastrophes, and their impact is regionally diverse. Legal entity based regulation may reduce the economic loss absorption capacity of well diversified insurance groups; and

<sup>8</sup> ACLI 2013 Life Insurers Fact Book.

while some companies are heavily exposed to particular events, national companies have diversified risks and the largest catastrophe risks are carried by reinsurers outside the United States.

## D. Preconditions for Effective Insurance Supervision

### Sound and sustainable macroeconomic and financial sector policies

**29. There is a highly developed economic and financial policy framework.** The goals of monetary policy are set out in the Federal Reserve Act, which requires the FRB to seek “to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.” The FRB aims also to contribute to financial stability and economic performance by acting to contain financial disruptions and to prevent their spread outside the financial sector. Fiscal policy is developed and implemented at state and federal government levels and revenue and expenditure budgets determined annually and in a transparent process by state legislatures and the U.S. Congress.

**30. The financial sector policy framework has been extensively reformed in recent years in response to the financial crisis.** The Dodd-Frank Act included strengthening of supervision, capital, and risk-management standards for financial companies and financial market utilities; procedures for periodic supervisory and company-run stress tests; rule-makings related to the orderly liquidation authority; regulation of the derivatives markets to reduce risk and increase transparency; new standards to protect mortgage borrowers and reduce risks in the mortgage market; and other measures on consumer and investor protection.

**31. The financial market primarily consists of three sectors, insurance, banking and securities, all subject to extensive regulatory arrangements.** The banking sector is regulated at the federal level by the FRB, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration. At the federal level, the Securities and Exchange Commission (SEC) oversees the securities industry SROs, including securities exchanges, clearing agencies, and the Financial Industry Regulatory Authority, and the securities industry as a whole, and is responsible for administering federal securities laws and developing regulations for the industry. The Commodity Futures Trading Commission (CFTC) regulates the markets for futures, options on futures, and swaps, and works to ensure the protection of customer funds, including those held by certain financial institutions operating in those markets. The CFTC oversees designated contract markets, swap execution facilities, derivative clearing organizations, swap data repositories, swap dealers, major swap participants, futures commission merchants, commodity pool operators, and other intermediaries.

### A well-developed Public Infrastructure

**32. The United States has a well-established infrastructure for financial reporting by market participants, including insurers.** For general purpose reporting to investors and creditors, U.S. firms follow Generally Accepted Accounting Principles (GAAP) as promulgated by the Financial

Accounting Standards Board (FASB). Both the FASB and International Accounting Standards Board are currently working on a convergence program, designed to bring U.S. and international financial reporting standards (IFRS) into a single framework. For firms whose shares are traded on exchanges, the SEC provides additional reporting requirements, oversight and enforcement. In 2002, the Sarbanes-Oxley Act created the Public Company Accounting Oversight Board (PCAOB), which establishes auditing and related professional practice standards for registered public accounting firms to follow in the preparation and issuance of audit reports. The PCAOB has standards in place for auditing, attestation, quality control, ethics, and independence.

**33. The United States has an independent judiciary and well-regulated accounting, auditing, and legal professions.** The judicial system is comprised of both federal and state arrangements. Judges in both federal and state courts must be members of the bar and generally have significant experience as practicing lawyers before becoming judges. Federal judges are appointed by the President with the advice and consent of the Senate and receive lifetime appointments. States vary in their methods of judicial appointment. Some follow a system similar to the federal system, i.e., the state governor appoints judges with some input from the legislature. Some states, however, appoint judges through a general election.

**34. Lawyers must receive a license to practice law from a state or states.** All states but one (Wisconsin) require applicants who are not already members of another state's bar to pass a bar examination prior to receiving a license. In addition to controlling admission into the profession, the states also regulate the profession. Regulation is often delegated to a self-regulatory organization, i.e., a state bar association. Lawyers are also subject to ethical standards set by the states.

**35. The legal and court system, at state and federal level, provide for disputes on insurance issues to be heard and resolved through enforceable decisions.** There is extensive insurance expertise in the legal profession. Mechanisms for alternative dispute resolution are rare by comparison with many other countries.

**36. There is an extensive body of actuarial standards—ASOPs—set by the Actuarial Standards Board (ASB).** This is a non-statutory self-regulatory body established by the five actuarial professional bodies to promulgate standards which actuaries must use when providing professional services in the U.S. ASOPs provide a principles-based framework to support professional advice, mainly in the form of guidance. They are not formally part of regulatory requirements (and may potentially conflict with such requirements) but reference is made to them in regulatory requirements such that actuarial work and opinions required for regulatory purposes must in practice comply with ASOPs.

**37. The requirement for use of ASOPs is contained in the (separate but identical) Codes of Professional Conduct which the professional bodies adopt and apply to members.** Ethical standards are set and enforced by the professional bodies themselves. A separate body, the Actuarial Board for Counseling and Discipline (ABCD) hears disciplinary cases and makes recommendations for action to the professional bodies themselves. Since it began work in 1992, the ABCD has recommended severe sanctions (public reprimand or expulsion) in 38 cases. There is extensive cooperation between the actuarial profession and NAIC, particularly on technical issues.

**38. There is a generally an adequate supply of professional services available to support the business of insurance and insurance regulation.** There are over 18,000 members of American

Academy of Actuaries. There is wide availability from public sources of the basic economic, financial data and social statistics relevant to insurance and insurance regulation. For example, data on mortality are made available by the actuarial bodies.

### **Mechanisms for Consumer Protection**

**39. An extensive set of provisions and processes are aimed at protecting consumers entering into insurance contracts.** In addition to regulation of insurance companies and intermediaries, regulators provide direct consumer services, particularly complaints handling but also consumer information and consumer education programs. State insurance departments analyze and respond to complaints, taking up issues with companies or intermediaries and requiring redress where appropriate. Some state regulators also publish inspection results of market conduct work.

**40. Guaranty funds have been established by each state to provide a safety net for policyholders and other claimants and beneficiaries of insurance coverage.** Guaranty fund protection is triggered by a judicial finding of an insurer's insolvency, and serves to indemnify, up to the limits<sup>9</sup> allowed by state law, policyholders and other claimants and beneficiaries of insurance coverage. Most personal lines insurance products are subject to some guaranty fund protection, the terms of which vary by state; however, some insurance lines, such as residential mortgage and credit insurance written by bond insurers, are not subject to guaranty fund protection since the beneficiaries of such insurance coverage are commercial enterprises only.

### **Efficient Financial Markets**

**41. The United States has efficient, deep, liquid, and transparent financial markets.** These markets include the New York Stock Exchange, NASDAQ, and futures exchanges, among others. These exchanges support the U.S. economy and have significant capitalization. The United States has a reliable, effective, efficient, and fair legal and judicial system, where judgments are enforced.

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<sup>9</sup> The scope and the extent of the coverage vary and depend on the products and states with a range from US\$ 100,000 to US\$ 500,000.

**Table 1. Summary of Observance with the ICPs**

<b>Insurance Core Principle</b>	<b>Level</b>	<b>Overall Comments</b>
1 - Objectives, Powers and Responsibilities of the Supervisor	PO	<p>Insurance regulators are clearly identified in law and have adequate powers, the more so when 2010 changes to the holding company system powers are adopted in all states. While the FIO has significant powers in relation to oversight of the sector and regulation, only the states and FRB have powers over insurance companies and/or their groups.</p> <p>While there are limited explicit statements of the objectives of states' insurance supervision in law, the body of state insurance law and the understanding and expression by state regulators of the objectives of their work are consistent with the promotion of a fair, safe and stable insurance sector for the benefit and protection of policyholders. However, states should ensure that the promotion of insurance business and excessive focus on affordability of insurance rather than fair treatment of policyholders, are not a part of regulatory objectives.</p> <p>The establishment of the FIO and extension of the FRB's mandate to the consolidated supervision of non-bank financial companies designated by the FSOC has introduced a new objective for insurance supervision in relation to the impact on U.S. financial stability—in line with a recommendation of the 2010 FSAP.</p> <p>The objectives of the FRB, however, do not explicitly include insurance policyholder protection. There appears to be scope for conflict, for example in case of stress affecting savings and loan company depositors or risks to financial stability. Risks to depositors or stability could be mitigated by actions that would be detrimental to the interests of insurance policyholders.</p>
2 - Supervisor	PO	<p>State insurance regulators generally have a high degree of day-to-day operational independence and accountability. They operate within a highly transparent framework, with an emphasis on open government, but are also able to protect confidential information received from firms and from other authorities. Legal protection of agencies and staff is adequate.</p> <p>There remain risks to independence in state governance arrangements. While the vesting of regulatory powers in the commissioner helps protect departments' operational independence, the arrangements for appointment and dismissal of commissioners in many states expose state supervision to potential political influence. Elected commissioners may be subject to the pressures of the electoral cycle.</p> <p>The high dependence on state legislatures in respect of principal legislation and for budgetary resources exposes departments both to political influence and to potential budgetary pressures. These risks are mitigated but not eliminated by NAIC processes, including the accreditation program.</p> <p>While states' financial resources appear broadly adequate for current work programs, levels of skills and expertise require development, as the technical demands of supervisory work change in line with regulatory reform and as</p>

		<p>market conduct regulation develops. Some departments are dependent on contractual staff for routine examination work. The application of statewide remuneration policies constrains departments' ability to hire specialist skills.</p> <p>The NAIC accreditation program has served state regulation well. The NAIC could now extend its scope, for example to the regulation of captives, market conduct and intermediary regulation. They could also introduce an increased focus on the quality of supervisory judgments.</p> <p>In addition to its need to build expertise in insurance regulation and supervision generally, the FRB would benefit from having more staff with understanding of insurance issues at senior levels.</p>
<p>3 - Information Exchange and Confidentiality Requirements</p>	<p>LO</p>	<p>The extent of information exchange involving U.S. supervisors has increased in recent years, facilitated by NAIC processes (as well as the accreditation program), the development of an extensive network of MoUs and the establishment of international supervisory colleges. Seven states have become signatories to the IAIS MMoU with many more in the process of applying or considering applying.</p> <p>Increased trust appears also to have been developing between supervisors, within the U.S. and with foreign regulators, facilitated by greater understanding and confidence in the ability of U.S. supervisors to protect confidential information. This process has further to go and needs to be actively managed, while there is also scope for broader cooperation and collaboration amongst regulators (see ICP25).</p>
<p>4 - Licensing</p>	<p>LO</p>	<p>The UCAA process and accreditation standard for licensing (which became part of the accreditation process in 2012) cover core requirements and contribute to the consistency of licensing requirements across states.</p> <p>However, inconsistency of requirements and practices remain a perceived opportunity for arbitrage, for example, lack of consistency of absolute minimum capital requirements and exemption of certain insurance activities. With regard to capital, once a company is operating and writing business, RBC becomes more relevant as the higher standard. Guidance on business model analysis exists and the accreditation process requires the analysis of their appropriateness through on-site reviews. However, documentation about business model assessment (such as peer comparison of cost structures, etc.) may not be sufficient for the accreditation process to validate appropriate and consistent application among states and across business lines.</p>
<p>5 - Suitability of Persons</p>	<p>LO</p>	<p>States rely to a high degree on onsite examination to identify and remedy issues with the suitability (in particular properness) of key individuals. In addition, existing examination practices tend to focus more on compliance (thus more on fitness), and the competence and integrity of key individuals are not an area of focus—or at least their assessment is not sufficiently documented.</p> <p>Lack of powers, such as an ongoing approval of Board, Senior Management and Key Persons in Control Functions, and other alternative mechanisms, such as disclosure, makes it difficult for state regulators to take formal regulatory action rather than applying moral suasion, as properness of key individuals tends to be judgemental and strong regulatory enforcement action is not appropriate in</p>



		many cases.
6 - Changes in Control and Portfolio Transfers	O	Although the 2010 amendment of the Model Holding Company Act has not been adopted by all states, all the requirements of the ICP have been adopted by all states.
7- Corporate Governance	PO	<p>Neither state nor FRB supervisors have set formal broad-based, insurance-specific governance requirements, at legal entity or at group/holding company level. Both state and FRB supervisors primarily rely on assessing the risks in individual companies and groups, through regular oversight and through the on-site supervisory process. The FRB is relying on guidance and a supervisory approach developed for banking groups.</p> <p>There is a highly structured approach for carrying out state evaluation work on governance in preparation for examinations and a thorough process for carrying out the examinations themselves, as evidenced in documentation reviewed by the assessors. However, reliance on company reporting requirements, examinations work and general state corporate governance requirements should be supported by governance requirements appropriate for insurance business—and which engage the board of directors in particular in overseeing the management of insurance risks, recognizing the interests of policyholders.</p> <p>The application by the FRB of an approach developed for large banks has intensified supervisory work on group-wide governance at FRB-supervised groups. Many management and governance issues are common to banks and insurance groups; and with only 17 groups to regulate, many of them large, the FRB can take a tailored firm-by-firm approach. However, the development of specific requirements for insurance groups is needed to help focus supervisory work on where insurers and banks are different, and on where the major risks in insurance groups arise.</p>
8 - Risk Management and Internal Controls	LO	<p>Neither states nor the FRB have a comprehensive set of requirements on risk management and controls tailored to the business and risks of insurance companies.</p> <p>In the absence of requirements on firms to have control functions, there is a risk that states' expectations of high standards in these areas are not communicated to and understood by companies as clearly as necessary. The thoroughness of the examination process, and comprehensiveness of the published examiners guidance, does, however, mitigate the risks, as does the framework of requirements introduced for financial controls in recent years. The introduction by the states shortly of a requirement for internal audit functions at larger firms will extend the framework further, in a proportionate way, as will the ORSA requirements in the area of risk management.</p> <p>The FRB can and does take a tailored approach to risk management and controls, as to other issues. However, FRB guidance material and the supervisory approach needs further development to address the particular expectations of groups that are mostly engaged in insurance business.</p>
9 - Supervisory Review and	LO	State regulators have a highly developed approach to offsite analysis, drawing on comprehensive legal entity reporting and a powerful analytical capacity and peer

Reporting		<p>review framework led by the NAIC. Their approach has been significantly strengthened by the further development of holding company system analysis and the enhanced role of the lead state regulator and will be further strengthened by new reporting requirements on corporate governance, if agreed at the NAIC.</p> <p>Financial condition examinations have become more risk-focused, with more attention to qualitative issues and forward-looking judgments on “prospective risks”; and they are more often coordinated with other states and conducted as examinations of groups. Market regulation examinations appear to have further to go in this regard.</p> <p>Even for financial examinations, there appears to be scope for more confidential judgments to be included in management letters. Furthermore, the continued requirement for publication of a factual examination report on a legal entity basis absorbs significant resource and risks misleading readers where confidential supervisory issues are under discussion. The states are, however, considering modifications to the format to make it more representative of the work performed under a risk-focused examination.</p> <p>A five years maximum examination cycle is long by comparison with financial sector regulators in many other countries and other US regulators, especially in respect to larger or otherwise higher risk firms. It could be shortened or supplemented with targeted examinations for larger groups (not mainly where there are indicators of potential risk, as at present), accepting that this would require significant resource reallocation.</p> <p>The FRB’s approach draws heavily at present on tools and techniques developed for the major banking groups. As recognized by the FRB, there is a need to adapt and supplement these with supervisory tools that are tailored for insurance groups, to the extent that these are the most significant risks in the group, as well as maintaining a focus (in the case of NBFCs) on those aspects of the group’s business that may cause financial stability risks.</p>
10 - Preventive and Corrective Measures	○	<p>States have a full range of powers to intervene, require remediation and to escalate their response as necessary and they use these powers in practice. The powers are supplemented by specific actions that the FRB may take in respect of holding companies subject to their regulation.</p> <p>In respect to financial conditions, the system of RBC-related company and regulatory action levels, the associated triggers and required actions provide for automatic intervention ahead of stress, but their extensive financial reporting and financial analysis tools, including RBC forward simulations, also equip supervisors with the ability to intervene on a discretionary basis and start discussions with senior management at an early stage.</p>
11- Enforcement	○	<p>States and the FRB have wide range of enforcement measures and use those actively and effectively.</p>
12 - Winding-up and Exit from the	○	<p>States have appropriate tools to wind-up insurance legal entities effectively while protecting policyholders’ benefits as far as possible. In practice, the level of insolvencies has been low, even during the financial crisis, although a significant</p>

Market		<p>number of companies (136 as of the end 2013) have entered into run-off.</p> <p>The relatively prescribed system of indicators of financial strain and procedures for dealing with troubled companies (including the FAWG process) has meant that interventions have been taken at an early stage.</p>
13 - Reinsurance and Other Forms of Risk Transfer	O	<p>The regulation of reinsurance is comprehensive and supervision practices appropriate, with due consideration of risks. The handbooks give detailed guidance on best practices and on the evaluation of reinsurance programs.</p> <p>State regulators analyze material intra-group reinsurance contracts. However, if an insurance group or holding has a complex web of retrocessions in place, there can be interactions which impact the value and potential performance of retrocessions in place.</p>
14 - Valuation	PO	<p>The current valuation standard for life insurers is prescriptive and in many cases formula-based. As insurance products have become more complex, the prescribed algorithms and formulae used to determine reserves have grown in complexity accordingly. New products often require tailor-made approaches for valuation. Assumptions used for reserving are often static and set at the time the insurance products were sold. The valuation standard has varying levels of conservatism, which leads to a lack of transparency. The valuation standard uses amortized cost for specific assets under a hold-to-maturity argument for assets that cover liabilities. This argument breaks down for products where appropriate risk management requires a frequent re-balancing of the asset portfolio. The valuation standard does not necessarily give appropriate incentives for dynamic hedging for products where this would constitute appropriate risk management.</p> <p>The shortcomings of the valuation standard are circumvented and mitigated by complex structures in which life insurers engage. In some states, affiliated captives can hold fewer assets to back reserves. Even at the captive level, the full formulaic reserve is required. However, for captives the difference between the full formulaic reserve and the economic reserve is allowed to be backed by other assets, which could include letters of credit, which do not meet the definition of an asset in GAAP or statutory accounting.</p> <p>PBR would reduce many of the shortcomings outlined above. It would be better placed to deal with complex products and would reduce the tendency to engage in regulatory arbitrage, i.e. via affiliated captive transactions. The supervisory review of PBR will require sufficient expertise of the state regulators.</p> <p>Allowing for conservatism explicitly in a margin over current estimate would increase transparency. The explicit decomposition of reserves into a current estimate and a margin over current estimate allows assessment of the overall conservatism for different lines of products. This would allow a recalibration of the valuation standard for products where reserves are overly conservative or not sufficient.</p> <p>Any capital requirement that the FRB has to develop has to be based on a valuation standard. The FRB should consider the development or use of a</p>

		valuation standard that is useful to capture the risk to which SLHCs and NBFCs groups are exposed.
15 - Investment	O	<p>The investment limits defined in the model acts, together with the detailed (and public) expressed expectation in the Financial Analysis Handbook and the Financial Condition Examiners Handbook constitute a sophisticated framework to limit investment risk. There is strong focus on liquidity risk and the security, liquidity and diversification of investments. Regulators have strengthened their requirements on securities lending. There is a strong focus on the liquidity position and overall limits on securities lending have been imposed.</p> <p>The current low-interest rate environment has already given rise to an increased hunt for yield, albeit from a low level. If some insurers increase their investments into more exotic asset classes, the NAIC might also consider adapting their definition of investments to ensure that insurers properly assign their investments to the appropriate asset classes. Although regulatory arbitrage transactions between insurers in different states have not been observed, there is a risk of regulatory arbitrage as investment limits of various states are not consistent at legal entity level and there is no group wide investment requirement.</p>
16 - Enterprise Risk Management for Solvency Purposes	LO	<p>The ORSA requirements of the State Regulators are not yet in force. Also, a number of requirements of ICP 16 are not strictly satisfied, e.g. requirements for insurers to have a risk management policy which includes explicit policies in relation to underwriting risk, but will be satisfied in spirit once ORSA is in force. The state regulators have a supervisory approach which for qualitative requirements relies less on explicit and detailed rules, but on high-level principles and expectations that are formulated in the handbooks for examiners and analysts. ORSA will be mandatory for larger companies that cover over 90 percent of the market by premium income.</p> <p>The FRB will need to continue to increase its expertise in insurance for the supervision of NBFCs and make rules and regulation more specific to insurers. ERM and ORSA require expertise on risk to which insurers are exposed not only from the supervised, but also from the supervisors. Insurers are not necessarily exposed to similar risks as banks nor do they react to adverse events identically to banks. Rules and regulations should reflect these differences.</p>
17 - Capital Adequacy	LO	<p>The RBC framework used by state regulators is a sophisticated, risk-based capital framework that has been improved continuously since it came into force in the early 1990s. The basis of the US solvency framework is an amortized cost valuation standard that is largely rules-based. This results in the RBC formulae becoming increasingly complicated as insurance products—in particular life insurance products—become more complex.</p> <p>It would also be useful if the RBC framework were to be documented in a consistent set of documents, including its methodology, parameterization and assumptions and implementation.</p> <p>Financial guaranty insurers and mortgage insurers are not subject to the RBC. While they are still required to hold minimum capital and surplus requirements,</p>

		<p>these have been shown to be not sufficient by a large margin during the financial crisis. In addition, it is not advisable for regulators to solely rely on external ratings, which performed badly in the run-up to the financial crisis.</p> <p>For groups and conglomerates, the focus on legal entity capital alone is not necessarily enough. The NAIC has put in place qualitative requirements. Quantitative group level capital requirements would enhance these qualitative requirements and help to increase transparency on the risks within a group and also reduce the risk of regulatory arbitrage.</p> <p>The FRB should develop and formulate its preferred approach to, for example, the underlying valuation standard to be used, the time horizon for capital, the risk measure of capital, and the legal entity or legal entities within the groups to which the capital requirement would be imposed.</p>
<p>18 - Intermediaries</p>	<p>LO</p>	<p>While producer regulation is less uniform than is the regulation for insurance companies, all states have requirements in relation to the key expectations of ICP18 - such as licensing, requirements in relation to producer skills and expertise, and powers to undertake examinations and to take action in case of producer misconduct.</p> <p>The general legal framework provides safeguards for client money where intermediaries act as agents (and this has been tested in numerous cases). There is less uniformity on the safeguards applying to money held by brokers, but premiums must generally be held in a fiduciary capacity and be accounted for by all agents and brokers. Requirements in relation to contingent commissions (such as are paid by insurers to major commercial lines brokers based on business volume) have been strengthened through a disclosure approach and as a result of New York action. Requirements are not the same in other states.</p> <p>All insurance producers, including the major brokers with large global presences are subject to supervision and must comply with state laws. While these institutions should clearly not be regulated or supervised in the same way as major insurance companies, closer oversight would be appropriate to reflect their high impact on policyholders and on market integrity.</p>
<p>19 - Conduct of Business</p>	<p>LO</p>	<p>There is an extensive body of requirements in relation to market conduct, much of it dating back many years and based substantially on the banning of certain unfair practices, requiring disclosure to customers and treating customers fairly; this is supplemented with specific requirements across the product range such as assessing suitability in relation to advice on sales of complex products.</p> <p>The comprehensive Market Regulation Handbook encompasses expectations on firms, including detailed material by types of insurance product, but does not create binding requirements. Market conduct examinations are being carried out, more regularly for insurers than for producers, and with a high degree of dependence on consultants to carry out the examinations in many states.</p> <p>There is a developing approach to market conduct risk analysis, although it is relatively lightly staffed. The states' approach remains in large part reactive, with a high degree of dependence on lagging indicators such as individual customer complaints. More focus on governance, culture (and the effect of incentives) and</p>

		<p>controls across the range of products, would be justified given that the U.S. market features complex products, mixed levels of financial literacy and a largely commission-based remuneration model.</p> <p>Aspects of the states' approach rely on NAIC processes (although without an accreditation process), including market analysis and the coordination of certain multistate efforts through MAWG. However, without greater uniformity in other areas such as the implementation of model laws, rate and form regulation and use of the Market Regulation Handbook, it is hard to assess whether market regulation is adequate across the states.</p>
20 - Public Disclosure	O	<p>Publicly disclosed information is extensive and sufficient for sophisticated users (e.g. rating agencies and financial advisors) to gain information into the exposure to risks from investments and liabilities. Financial statements are filed electronically except for small companies, allowing the efficient analysis of the information. The use of off-balance sheet items has to be disclosed in notes. The use of complex structures, i.e. transfer of business to affiliated captives, where business is moved off-balance sheet, reduces transparency and requires analysis by specialists. However, this is possible in principle.</p> <p>Insurance groups and insurance holding systems should be required to submit financial filings on a consolidated level and this information should be made publicly available. This would give additional insight and useful information to the public as well as to regulators. While publicly traded groups have to file consolidated financial information on a US GAAP basis, statutory accounting would be useful not just for regulatory purposes but also for the public as the basis for analysis of exposure to risk.</p> <p>While public disclosure is extensive, its usefulness for decision making is hampered by the valuation standard it is based upon (see ICP 14).</p>
21 - Countering Fraud in Insurance	O	<p>State regulators address fraud-related issues by conducting market conduct examinations to ensure that effective Antifraud Plans have been implemented by insurers. The availability of data on fraud has been improved significantly with the development of databases, which has resulted in number of enforcement actions.</p>
22 - Anti-Money Laundering and Combating the Financing of Terrorism	LO	<p>While both federal and state authorities have roles in relation to AML/CFT regulation, key aspects of the U.S. regime for insurance are set out in the federal Bank Secrecy Act and accompanying regulations. FinCEN is the responsible federal authority, with the IRS having delegated authority for examinations, although there are plans over time for FinCEN to rely more on state regulators' AML/CFT examinations so as to avoid duplication of examination effort, allowing redirection of scarce IRS resources (although it may still carry out targeted examinations of insurers), and to recognize state expertise. State insurance supervisors already have an awareness of AML/CFT issues, resulting from their own supervisory work and liaison with federal authorities.</p> <p>Cooperation in practice between federal regulators and the states appears good. FinCEN, State Regulators and NAIC have established MoUs and are cooperating to share relevant information. There are currently 11 MoUs completed between FinCEN and state regulators. FinCEN plans to expand its information-sharing</p>

		<p>MoU network to additional states, supplementing its current outreach action plan and regular attendance at NAIC meetings. Exchange of information can and does take place without a MoU, and there are no legal restrictions on such exchanges.</p>
<p>23 - Group-wide Supervision</p>	<p>PO</p>	<p>Group supervision has been improved and strengthened. The Insurance Holding Company System Model Act allows state regulators to supervise insurance groups. The FRB exercises consolidated supervision over SLHCs and NBFCs.</p> <p>To assess an insurance group as a whole, it can be necessary to analyze the interaction of the ownership structure of the entity with the web of intra-group transactions. This requires information, which U.S. states can demand of any insurer or its affiliates, and can use to take action on the insurer, if the non-insurance entities or holding companies create a risk to the insurer.</p> <p>There are no capital standards in place, either for groups supervised by state regulators or for SLHCs and NBFCs supervised by the FRB. The analysis and assessment of a group’s financial position in current and in stressed situations requires an appropriate valuation and capital standard, without which the impact of the web of intra-group transactions, the transmission of losses through the group and the failure mode of the group cannot be evaluated soundly.</p> <p>Resolution planning might be workable without a sound capital framework since the U.S. states can request any information from the group that the state believes is necessary to understand the risk the group poses to the insurer. In contrast, a regulatory framework that aims for policyholder protection has to consider events that are catastrophic for insurance legal entities, which state regulators have the authority to assess under the Insurance Holding Company System Model Act.</p> <p>A stress testing regime for insurance groups and holding companies would support state regulators in assessing risks within groups they supervise. In the absence of a group-wide valuation and capital standard, stress testing—if defined appropriately—would help state regulators to gain insight into the exposures to risk of regulated entities.</p> <p>There are no group wide investment, market conduct and disclosure requirements in place.</p>
<p>24 - Macroprudential Surveillance and Insurance Supervision</p>	<p>LO</p>	<p>There are a number of regulatory authorities and other bodies involved in macroprudential surveillance and insurance supervision. The sophistication of the macroprudential surveillance is not yet congruent with the complexity of the US financial sector. There is further scope for the surveillance on interlinkages between financial sectors, exposures to systemic risks and interactions of different regulatory systems. The insurance industry is highly exposed to system-wide risks, e.g. low interest rates or the failure of a systemically important banks, which should be analyzed and appropriate macroprudential measures be taken.</p> <p>The FIO, FSOC the FRB and the NAIC combined constitute a framework for macroprudential surveillance and insurance supervision. There are numerous agencies and offices analyzing data and engaging in research on systemic risk</p>

		<p>and macroprudential issues. However, macroprudential work relevant to insurance sector is still in a developing stage.</p> <p>The cooperation of different authorities and offices can be improved on macroprudential issues relevant to insurance sector. There is likely some duplication of efforts and a pooling of resources might increase the overall quality. As an example, the FRB is aiming to develop insurance specific stress tests and might in this benefit from closer cooperation with the states and the NAIC.</p> <p>Delivering appropriate representation for insurance at the FSOC has been complicated by the fragmentation of responsibilities for insurance supervision and oversight. The Box in the introduction to this assessment considers options for a response.</p> <p>The concept of systemic relevance for NBFCs should be clearly defined by the FSOC. Such a definition would support also the analysis of the FSOC and the OFR on emerging threats and the identification of risks to the US financial system. Stress testing and crisis management exercises involving the FRB would provide good insight into the systemic impact of NBFCs.</p> <p>The states and NAIC might consider introducing a stress testing regime. A formal, regular stress testing framework for the insurance industry would give valuable information. Ideally, for financial market stresses, the framework would be aligned as far as feasible to the FRB CCAR framework. This would give additional insights into cross-sectoral interlinkages.</p>
<p>25 - Supervisory Cooperation and Coordination</p>	<p>LO</p>	<p>U.S. insurance regulation has developed a significantly stronger focus on domestic and international supervisory coordination in recent years. This reflects the states' development of the holding company analysis framework; the growth in supervisory colleges under the IAIS framework; and the strengthening of SLHC, and addition of group-wide NBFC supervision by the FRB, which has become the lead regulator (Group-Wide Supervisor) of the groups which it supervises.</p> <p>At state level, the lead state concept is now embedded in the regulatory system and is delivering stronger coordination, including on troubled companies. However, there remain limitations on cooperation between state regulators, which partly reflects the lack of uniformity in regulatory approaches.</p> <p>State regulators' cooperation with FRB supervisors is developing, based on a complementarity of approaches (legal entity and group focus), although the FRB's role is still relatively new and relationships in practice have further to develop for some groups.</p> <p>The absence of U.S. or global group-wide capital standards (see ICP23) constrains to an extent the lead state holding company analysis process as well as the FRB's group-wide supervision and the work of the colleges; but U.S. regulators have not let this prevent the establishment and effective functioning of supervisory colleges in an information-sharing and coordination role.</p>



<p>26 - Cross-border Cooperation and Coordination on Crisis Management</p>	<p>LO</p>	<p>The U.S. authorities' approach to cross-border crisis management and coordination is at an early stage of development, reflecting the recent establishment of colleges of supervisors and, for the two NBFCs, Crisis Management Groups (CMG). The application to the NBFCs of much of the same framework as applies to other large financial institutions under Dodd-Frank has brought early progress, rigor and consistency to the process for resolution plans ("living wills").</p> <p>Outside the college framework (which is generally limited to IAIGs), U.S. supervisors have coordinated with both foreign and multiple U.S. state jurisdictions in the management of a troubled company effectively, although the crisis did not extend to a failure of any company involved.</p> <p>There appears scope for using the colleges (or smaller groups of college members as for the CMGs) to undertake crisis preparedness, including more sharing of information on group structures, intra-group transactions and potential barriers to effective crisis management.</p> <p>In relation to resolution, including the operation of Dodd-Frank Act processes for the management of a crisis where systemic risk is potentially at issue and there has been a systemic risk determination, work is also an early stage. The capacity of the authorities to manage a resolution of a cross-border insurance group will need further development.</p>
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## E. Recommendations and Authorities' Response

**Table 2. Summary of Observance Level**

Observed (O)	8
Largely observed (LO)	13
Partly observed (PO)	5
Not observed (NO)	0
Total	26

**Table 3. Recommendations to Improve Observance of the ICPs**

<b>Insurance Core Principle</b>	<b>Recommendations</b>
1 - Objectives, Powers and Responsibilities of the Supervisor	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>all states adopt the joint statement of the objectives of insurance regulation and review their legislation to ensure that it is consistent with the statement (for example, that any mandate to promote or develop the insurance sector that could conflict with the statement is eliminated); and</li> <li>regulators undertake analysis of potential conflicts between the objectives of the SLHC regime and the objectives of insurance supervision, as set out in the ICPs, and recommend changes in the legislation as appropriate, which may include more explicit recognition of the objective of insurance policyholder protection.</li> </ul>
2 - Supervisor	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>states reform arrangements for the appointment and dismissal of commissioners, providing for fixed terms for all, with dismissal only for prescribed causes and with publication of reasons;</li> <li>state governments increase the independence of insurance departments in relation to resourcing, enabling them to determine budgets, set and retain relevant fees and assessment income to finance their work and employ appropriate staff as necessary to meet their objectives, subject to continued accountability to state legislatures;</li> <li>the NAIC review the scope and operation of the accreditation program, including the potential value of an element of external assessment and a quality assurance element to accreditation work; and</li> <li>the FRB continue to increase its insurance expertise (particularly in the area of actuarial methods, insurance accounting and underwriting risk), including in senior positions, to ensure the effectiveness of its insurance group supervisory work.</li> </ul>
3 - Information Exchange and Confidentiality Requirements	<p>It is recommended that states and the FRB review their internal processes and procedures, including staff training, to ensure that supervisors understand the importance of sharing information, including proactive sharing, taking into account the need to ensure confidentiality.</p>

4 - Licensing	It is recommended that states improve consistency of the licensing requirements among the states both at high level (such as the absolute minimum capital level and the scope of exemption from licensing) and practical interpretation level (through better documentation of analysis and more detailed accreditation review work).
5 - Suitability of Persons	It is recommended that: <ul style="list-style-type: none"> <li>state regulators adopt and implement the Corporate Governance Annual Disclosure Model Act and related regulation and handbooks promptly; and</li> <li>state regulators require examiners and supervisors to state more clearly their observations of properness of key individuals at least in their internal documentations, so that appropriate regulatory actions can be followed up.</li> </ul>
7 -Corporate Governance	It is recommended that states and the FRB develop appropriate standards for insurance company governance, to be applied at legal entity and/or group level and implement these through the model law process or FRB requirements.
8 - Risk Management and Internal Controls	It is recommended that: <ul style="list-style-type: none"> <li>after the introduction of the ORSA regime and requirement for an internal audit function, the states review the range of their standards on risk management and control functions, assessing whether standards embedded in the ORSA requirement should be applied to a wider population of firms and whether to require at least the larger firms to have risk management, compliance and actuarial functions; and</li> <li>the FRB develop and communicate a set of expectations in relation to risk management and internal controls for insurance NBFCs and SLHCs.</li> </ul>
9 -Supervisory Review and Reporting	It is recommended that: <ul style="list-style-type: none"> <li>the states review the adequacy of reporting on qualitative issues such as material outsourcing and adopt the proposed new framework for corporate governance reporting;</li> <li>the states review the scope for a higher frequency of examinations or increased targeted examinations between the regular full scope examinations, for the larger groups; and consult on whether they should remove the requirement for examination reports to be published;</li> <li>the states review the scope for more coordinated multistate market conduct examinations; and</li> <li>the FRB develop and publish a tailored supervisory framework and appropriate tools addressing insurance risks for the supervision of the SLHC and NBFC insurance groups, including stress tests that include insurance risk scenarios such as a major pandemic.</li> </ul>
12 -Winding-up and Exit from the Market	It is recommended that the states work closely with federal and International regulators, and resolution authorities to improve resolvability of large and complex insurance groups.
13 -Reinsurance and Other Forms of Risk Transfer	It is recommended that: <ul style="list-style-type: none"> <li>state regulators analyze the interaction of the web of retrocessions and the group's or holding's structure in more depth; and</li> <li>the FRB analyze the interaction of the web of retrocessions in particular for systemically important insurance groups.</li> </ul>
14 - Valuation	It is recommended that: <ul style="list-style-type: none"> <li>the NAIC continues to pursue the update of the valuation methodology for life insurers based on principles-based reserving;</li> <li>captives and insurers have to use the same valuation requirements;</li> </ul>

	<ul style="list-style-type: none"> <li>the valuation standard is applied consistently across all states;</li> <li>the valuation standard is consistently defined taking into account how assets that cover liabilities are actually managed;</li> <li>the valuation standard is adapted such that it captures conservatism explicitly in a margin over current estimate;</li> <li>state regulators authorities ensure that they have sufficient expertise in-house to cope with principles-based approaches to reserving; and</li> <li>the FRB defines a valuation standard for their regulated insurance entities.</li> </ul>
15 -Investment	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>identical investment rules and limits are imposed on affiliated captives to which insurance liabilities are ceded to; and</li> <li>state regulators with cooperation with the NAIC, FRB and FIO to continue to analyze investment activities both at legal entity level and group level and address any regulatory arbitrage by improving consistency of investment requirements among states and federal regulations.</li> </ul>
16 -Enterprise Risk Management for Solvency Purposes	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>the FRB continues to enhance their expertise in insurance risk and business models;</li> <li>the FRB adapts its rules and regulation and approaches to take into account the specifics of insurers, where warranted; and</li> <li>the state regulators and the NAIC consider requiring the ORSA for all insurers, proportionate to the size and complexity of the firms.</li> </ul>
17 -Capital Adequacy	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>state regulators and the NAIC develop an RBC requirement for financial guaranty insurers, taking into account their specific exposures to risk;</li> <li>state regulators and the NAIC develop an approach that would allow RBC to capture intra-group transactions (IGTs);</li> <li>the FRB develops a capital standard for NBFs and SLHC, with due consideration of accounting and actuarial standards, developing its methodology in cooperation with state regulators and the NAIC; and</li> <li>state regulators, the NAIC and the FRB coordinate to develop common or consistent capital requirements to avoid regulatory arbitrage between the two capital requirements.</li> </ul>
18 - Intermediaries	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>a uniform approach to the regulation of larger business entities, including major commercial lines brokers be developed; and</li> <li>producers in all states be required to make disclosures to customers of the status under which they are doing business, including which insurance companies have appointed them.</li> </ul>
19 -Conduct of Business	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>states further develop market conduct requirements that address the risks of unfair policyholder treatment across the range of insurance products and including requirements to treat customers fairly, to act with due skill and diligence, give suitable advice and to manage conflicts of interest;</li> <li>states develop a risk-focused surveillance framework specifically for market conduct to support proactive, risk-based supervision of market conduct, covering both the supervision of individual firms and of issues that arise across the market;</li> <li>states review staffing and resourcing models for market conduct regulation of insurers and producers, including scope to undertake more examination work</li> </ul>

	<p>using employees rather than consultants (see also ICP2 on resources); and</p> <ul style="list-style-type: none"> <li>• states continue to give consideration to developing an accreditation program for market conduct work (initial discussions have already been held), building on the work of the MAWG and on the comprehensive Market Regulation Handbook.</li> </ul>
20 - Public Disclosure	It is recommended that insurance groups and insurance holding systems are required to submit financial filings also on a consolidated level.
22 -Anti-Money Laundering and Combating the Financing of Terrorism	It is recommended that to facilitate active and effective information sharing on AML/CFT, FinCEN, state regulators and the NAIC continue to expand the network of MOUs and speedily implement the ongoing project for electronic information exchange.
23 -Group-wide Supervision	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• state regulators obtain direct legal authority over the insurance holding company (although this is beyond the current ICP);</li> <li>• capital standards are put in place in a consistent manner, for groups supervised by state regulators and by the FRB;</li> <li>• potential conflicts between the objectives of different supervisory authorities are addressed;</li> <li>• a stress testing regime for insurance groups and holding companies be implemented;</li> <li>• consolidated financial statements are published by all insurance groups; and</li> <li>• investment activities at the group level are carefully monitored to address potential regulatory arbitrage and search for yield at the group level.</li> </ul>
24 - Macroprudential Surveillance and Insurance Supervision	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• different authorities and offices work closer together on macroprudential issues;</li> <li>• the FSOC encourage the FRB to develop stress testing and crisis management exercises which are meaningful for the insurance sector; and</li> <li>• the representation of the insurance sector is brought into line with that for other sectors on FSOC.</li> </ul>
25 - Supervisory Cooperation and Coordination	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• states and the FRB review how to develop stronger cooperation between U.S. insurance supervisors, which could include increased joint working (e.g., on-site work), secondments and appropriate training; and the FIO and NAIC work more closely together, for example to develop a shared view on priorities for modernization of insurance regulation;</li> <li>• state regulators and FRB set objectives for colleges to move to the next level of cooperation, including potentially the development of a shared group risk assessment and joint working; and consider whether this may require sub-groups of members or colleges to meet in a core group format to promote efficient working; and</li> <li>• states fully and effectively incorporate the state regulators' collective expectations on international supervisory colleges into the accreditation program.</li> </ul>
26 - Cross-border Cooperation and Coordination on Crisis Management	It is recommended that the authorities continue their work in relation to crisis preparedness, giving priority to building on the work of the CMGs (and current work at the FSB and the IAIS) to develop their planning for a crisis and resolution of a major cross-border group. Supervisors should ensure that all internationally-active groups have developed contingency plans and are able to deliver information that may be required in a crisis in a timely fashion.

## F. Authorities' Responses to the Assessment

**42.** The Federal Reserve Board (FRB), the National Association of Insurance Commissioners (NAIC), and the Federal Insurance Office (FIO) (collectively, the "U.S. authorities") welcomed the opportunity to take part in the second U.S. FSAP and support the objectives of the IMF's FSAP more generally.

**43.** The current Insurance Core Principles (ICPs), as amended by the IAIS in 2013, are more rigorous and comprehensive than the prior version used for the first U.S. FSAP conducted in 2010. The U.S. authorities are therefore pleased that the IMF's current assessment of the U.S. system broadly indicates compliance with such principles; that insurance supervision in the United States has been significantly strengthened in recent years; that lessons have been learned from the financial crisis; and that many of the recommendations of the 2010 FSAP are being addressed.

**44.** The Report recognizes that the implementation of global and domestic reforms, particularly the Dodd-Frank Act (DFA) and ongoing enhancements at the state level, has increased the supervisory scope and intensity of insurance supervision and oversight. Some state and federal reforms are pending and will take time to fully implement, including at the federal level those related to enhanced prudential standards for non-bank financial companies. The Report acknowledges that additional implementation of the reform programs will further improve compliance with the ICPs in the United States.

**45.** The U.S. authorities are pleased with the Report's overall evaluation, which concludes as follows:

- Overall, the assessment finds a reasonable level of observance of the Insurance Core Principles. There are many areas of strength, including at state level the powerful capacity for financial analysis with peer group review and challenge through the processes of the National Association of Insurance Commissioners (NAIC). Lead state regulation is developing and a network of international supervisory colleges has been put in place. Regulation benefits from a sophisticated approach to legal entity capital adequacy (the Risk-Based Capital approach). Regulation and supervision continue to be conducted with a high degree of transparency and accountability. FRB supervision is bringing an enhanced supervisory focus to group-wide governance and risk management. Cooperation between state and federal regulators is developing, based on the complementarity of their approaches, although it has further to go.
- The Report makes numerous recommendations to increase U.S. compliance with the ICPs. The U.S. authorities acknowledge that some continued reforms are worth considering to further strengthen certain aspects of the system of regulation and supervision in the United States. However, the state regulators disagree with a few of the ratings ascribed to certain ICPs and the U.S. authorities do not believe that each of the proposed regulatory reforms recommended in the Report is warranted, or would necessarily result in more effective supervision, reduced cost and complexity of insurance supervision, or successfully address

perceived regulatory gaps, especially when compared to functional outcomes. For example, the Report expresses concern that the objectives of the respective agencies could come into conflict in a crisis situation. In practice, there is clarity of mission among the U.S. authorities and, to date, they have resolved potential conflicts through regulatory and supervisory cooperation.

46. The U.S. authorities appreciate the work of the assessors and look forward to continuing dialogue with the IMF as the authorities consider the recommendations.

## DETAILED ASSESSMENT

<b>Table 4. Detailed Assessment of Observance of the ICPs</b>	
<b>ICP 1</b>	<p><b>Objectives, Powers and Responsibilities of the Supervisor</b></p> <p>The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.</p>
Description	<p><b>Regulatory Structure</b></p> <p>Insurance regulation and supervision is a shared responsibility of federal and state authorities, with authorities and powers defined in relevant state and federal statutes (i.e. primary legislation). The 1945 McCarran-Ferguson Act established state jurisdiction over insurance, clarifying that state laws governing the business of insurance are not invalidated, impaired, or superseded by any federal law unless the federal law specifically relates to the business of insurance.</p> <ul style="list-style-type: none"> <li>• The <u>states</u>, through the insurance departments of state administrations, have responsibility for licensing, regulating and supervising insurance companies and intermediaries, focusing on the individual legal entity (they do not license holding companies), but with powers to assess and respond to group-wide risks.</li> <li>• The <u>FRB</u> has no authority to license individual insurance companies, but has a major role in insurance regulation and supervision through its primary federal responsibility for consolidated regulation of:             <ul style="list-style-type: none"> <li>- bank holding companies under the Bank Holding Company Act (BHC Act)—to the extent that there are one or more insurance companies as well as at least one bank in the group (there are no such groups at present);</li> <li>- savings and loan holding companies (SLHCs) under the Home Owners’ Loan Act (HOLA) (to the extent that are one or more insurance companies as well as at least one savings and loan company in the group—there are 15 such groups at present, including four of the largest insurers in the country); and</li> <li>- insurance companies which are non-bank financial companies (NBFCs), where the company has been designated under the Dodd-Frank Act by the FSOC for FRB supervision (there are two insurance groups at present, AIG and Prudential Financial).</li> </ul> </li> <li>• The <u>FIO</u> has no authority to license or regulate individual insurance companies or to undertake supervision, but under the Dodd-Frank Act, it has a broad monitoring role</li> </ul>

	<p>for the insurance sector and its regulation, a lead role in international aspects of insurance regulation and certain specific responsibilities in relation to systemic risk in the insurance sector.</p> <p>Other bodies, both, state and federal, also have a role in aspects of insurance regulation, including the FSOC (in relation to designation of NBFCs and identification of risks to financial stability), state securities regulators and the SEC (and FINRA) in relation to products and practices covered by securities laws; the Department of Labor in relation to workplace pension products; and FinCEN and the IRS in relation to AML/CFT regulation and supervision (see ICP22).</p> <p>The FDIC has certain powers in relation to the resolution of insurance companies and holding companies under the Dodd-Frank Act (see ICP12).</p> <p><b>Objectives of Insurance Supervision</b></p> <p>In relation to <u>state supervision</u>, estate insurance departments express their objectives (or mission) individually and differently, including the maintenance of competitive insurance markets; eliminating fraud, other criminal abuse or unethical conduct in the industry; focusing on consumers' needs for affordable and available products; and fostering the development of the insurance industry. State insurance laws prescribe statutory obligations on a comprehensive range of subjects related to the business of insurance.</p> <p>In practice, states are guided by NAIC Model Laws and individual state insurance codes which implicitly set objectives of: (i) ensuring the financial soundness of insurance companies, so as to limit consumers' exposure to loss due to financial failure; and (ii) promoting appropriate standards of market conduct (by companies and intermediaries). The focus on consumer protection is reflected in the NAIC's accreditation program with its objectives of ensuring there are "adequate solvency laws and regulations in each state to protect insurance consumers."<sup>10</sup></p> <p>In line with a recommendation in the 2010 FSAP, states have developed a joint statement of the objectives of insurance regulation for posting on insurance department websites. This refers to key objectives as being to "better protect the interest of consumers while ensuring a strong, viable insurance marketplace". 12 states have posted the statement to date.</p> <p>There are no separate objectives in state insurance law in relation to group supervision (ICP1.2.3), which is seen as a tool to further the objective of supervision of individual insurance companies.</p> <p>The objectives of the <u>FRB's</u> regulation and supervision differ between:</p> <ul style="list-style-type: none"> <li>• BHCs and SLHCs, where the objective is to ensure that companies that control banks or savings and loan companies operate in a safe and sound manner and in compliance with banking laws; there are no explicit objectives in relation to the insurance sector and policyholders; and</li> <li>• NBFCs, where the objective is to ensure that the company operates in a safe and sound manner and to prevent or mitigate risks to U.S. financial stability that could arise from the material financial distress or activities of an NBFC. The Dodd-Frank</li> </ul>
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<sup>10</sup> As it is not itself a regulator, the NAIC's objectives are expressed in relation to its role in providing assistance and support for state regulators in achieving their goals.



Act requires the FRB to apply enhanced prudential standards and early remediation requirements to NBFCs. There are no explicit objectives in relation to insurance policyholders.

The objectives of the FIO set out in the Dodd-Frank Act are extensive and varied. It has responsibility to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system; and to develop federal policy on prudential aspects of international insurance matters.

The FIO does not issue regulations, but may determine (after consultation with relevant states, the U.S. Trade Representative and others) that “state insurance measures”, i.e. state laws and regulations, are pre-empted by “covered agreements.” These are defined as agreements entered into between the U.S. and foreign governments or authorities on prudential measures in relation to insurance or reinsurance with a level of protection for consumers substantially equivalent to the level of protection achieved under state regulation. No covered agreements have been negotiated by the U.S. government and no pre-emption determinations have been made by the FIO as yet. (The scope of pre-emption is limited to the subject matter contained within the covered agreement, and pre-emption may take effect only following a process that requires review and notice at several stages.)

The FIO also has specific responsibilities, including to recommend to the FSOC the designation of NBFCs and to recommend a “systemic risk determination” to place an insurance company or relevant holding company into receivership (see ICP12). (*31 U.S.C. § 313 – Dodd-Frank Act, Title V, and 12 U.S.C. § 5383(a)(1)(C) – Dodd-Frank Act, Title II*)

### **Legal Powers**

States have extensive powers under insurance legislation to license, supervise and take enforcement action against insurance companies and intermediaries. They also have powers in certain areas to make rules by administrative means—mostly in the form of regulations covering detailed requirements under delegated authority from state legislatures. State insurance departments may also issue bulletins and circular letters that provide instruction and notice on the application of laws and regulations.

The legislatures themselves enact most of the principal regulatory requirements. Insurance departments have powers to enforce both state laws and their own regulations.

The NAIC issues Handbooks (on financial analysis, financial examinations, market regulation and dealing with troubled companies) that are developed by the states through the NAIC process and used by the states in their supervisory work. Some of this material, which is publicly available for a charge, sets out states’ expectations in particular areas, such as governance and controls.

States can take immediate action, if they consider it necessary—including using receivership powers against companies—to protect policyholders. These actions are not subject to suspension on appeal.

In relation to group supervision, the NAIC Insurance Holding Company System Regulatory Model Act, adopted in its original version by all states, contains powers for states to undertake group supervision, including powers to obtain information from a holding company. Various transactions involving an insurer and any member of its insurance holding company system (i.e., the group - up to and including the ultimate

holding company) are subject to prior approval. States may examine any insurer and affiliates to ascertain the financial condition of the insurance company. Implementation of the Act and its accompanying regulation (or enactment of substantially similar measures) is an accreditation standard.

However, enhanced powers are available through a 2010 revised version of the Act that will be part of the NAIC accreditation program as of January 2016, although it is already in force in the 38 states which have adopted it to date. This gives states authority to obtain consolidated financial reports upon request, to require an enterprise risk report for the full holding company structure and to enable participation in supervisory colleges. The revised version also extends states' regulatory access to holding company information. (*Model Law 440, January 2011*).

The revised law does not give states authority to license holding companies.

The FRB has extensive powers in relation to its responsibilities for group-wide supervision of BHCs, SLHCs and NBFCs. It issues and enforces regulations by administrative means and has a range of powers to take action. It may carry out examinations on the licensed insurance company within the group, but is also required to rely to the fullest extent possible on examinations conducted by the state regulators and notify them before conducting an examination.

The extent of the FRB's powers is closely aligned to the objectives of SLHC and NBFC supervision and its powers do not extend to intervention in a licensed insurance company, except in cases where the insurance company is itself an SLHC. However, the FRB has the power, in case of non-compliance by an NBFC with its requirements or potential threats to financial stability, to recommend to a state insurance regulator that it take action and to take action itself if the state insurance regulator fails to act within 60 days. (*12 U.S.C. § 5362*)

As mentioned, the FIO does not have powers to issue or enforce regulations, but has several statutory authorities under the Dodd-Frank Act. Under Title V of the Act, FIO is authorized: (1) to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system; (2) to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance; (3) to recommend to the FSOC that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the FRB; (4) to assist the Secretary of the Treasury in administering the Terrorism Risk Insurance Program established in the Department of the Treasury under the Terrorism Risk Insurance Act of 2002; (5) to coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the IAIS (or a successor entity) and assisting the Secretary in negotiating covered agreements; (6) to determine (in accordance with Title V) whether state insurance measures are preempted by covered agreements; (7) to consult with the states (including state insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance; and (8) to perform such other related duties and authorities as may be assigned to FIO by the Secretary. (*31 U.S.C. § 313(c)(1)*).

	<p><b>Conflicts between objectives</b></p> <p>Although there are no specific mechanisms for identifying and addressing conflicts between their individual objectives, the states, the FRB and FIO consider that such conflicts would become evident and would be resolved through consultation and cooperation or, if necessary by legislative change. No such conflicts have been identified in practice.</p> <p>In relation to the totality of U.S. insurance regulation, the FIO has a responsibility to identify gaps that could impact on stability (and has done so in its December 2013 report “How To Modernize And Improve The System Of Insurance Regulation In The United States”). However, the FIO has no powers to require such gaps to be addressed.</p>
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>Insurance regulators are clearly identified in law and have adequate powers, the more so when 2010 changes to the holding company system powers are adopted in all states. While the FIO has significant powers in relation to oversight of the sector and regulation, only the states and FRB have powers over insurance companies and/or their groups.</p> <p>While there are limited explicit statements of the objectives of states’ insurance supervision in law, the body of state insurance law and the understanding and expression by state regulators of the objectives of their work (including in the recently-developed joint statement of objectives) are consistent with the promotion of a fair, safe and stable insurance sector for the benefit and protection of policyholders.</p> <p>However, state regulators should ensure that the promotion of insurance business, or excessive focus on affordability of insurance rather than fair treatment of policyholders, are not a part of regulatory objectives, explicitly or otherwise, especially given states’ interests in promoting the growth of the insurance sector as a significant provider of employment and state revenues.</p> <p>The establishment of the FIO and extension of the FRB’s mandate to the consolidated supervision of non-bank financial companies designated by the FSOC has introduced a new objective for insurance supervision in relation to the impact on U.S. financial stability—in line with a recommendation of the 2010 FSAP.</p> <p>The objectives of the FRB, however, do not explicitly include insurance policyholder protection. There appears to be scope for conflict, for example in case of stress that affecting savings and loan company depositors or risks to financial stability, although no such conflicts have arisen to date. Risks to depositors or stability could be mitigated by actions that may be detrimental to the interests of insurance policyholders—accepting that the FRB has limited powers to intervene directly in an individual insurance company.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• all states adopt the joint statement of the objectives of insurance regulation and review their legislation to ensure that it is consistent with the statement (for example, that any mandate to promote or develop the insurance sector that could conflict with the statement is eliminated); and</li> <li>• regulators undertake analysis of potential conflicts between the objectives of the SLHC regime and the objectives of insurance supervision, as set out in the ICPs, and recommend changes in the legislation as appropriate, which may include more</li> </ul>

	explicit recognition of the objective of insurance policyholder protection.
<b>ICP 2</b>	<p><b>Supervisor</b></p> <p>The supervisor, in the exercise of its functions and powers:</p> <ul style="list-style-type: none"> <li>• is operationally independent, accountable and transparent;</li> <li>• protects confidential information;</li> <li>• has appropriate legal protection;</li> <li>• has adequate resources; and</li> <li>• meets high professional standards.</li> </ul>
Description	<p><b>Governance, accountability and operational independence</b></p> <p>In relation to the <u>states</u>, governance structures vary, but in all insurance departments, authority to exercise functions and powers under state law and regulations is granted to the commissioner, i.e. to an individual rather than a body such as a Board of Directors. Powers may be delegated within an insurance department; for example, from the commissioner to the chief examiner.</p> <p>Relationships with the legislature and executive authorities are clear—legislatures enact state laws and set spending limits and may be involved in the appointment of the commissioner. Insurance departments are accountable to legislatures to whom they report annually on their activities (in published reports). They act independently of state legislatures and other state executive offices in their day to day work. No decisions require the involvement of executive officers outside the department, for example the state governor.</p> <p>State insurance departments are organized into sections with responsibility for defined areas (e.g., financial surveillance and producer licensing). Financial and market regulation responsibilities are usually organizationally separate, but there are procedures for exchange of information, for example in the NAIC Financial Condition Examiners Handbook. There are also procedures for escalation of issues internally, including to the chief examiner and commissioner.</p> <p>The NAIC accreditation program includes a review of policies and procedures for regulatory actions and the timeliness and appropriateness of action taken. Escalation procedures are required (and were evidenced in state insurance departments visited) for major decisions, for example changes of control and approvals of intra-group transactions. Immediate decisions can and are taken in case of emergency. Many departments have their own internal auditor (reporting to the commissioner) and most are also subject to the internal audit arrangements of the state administration.</p> <p>NAIC processes, including in relation to financial analysis of major and troubled companies (see ICP9), as well as codes of ethics contribute to mitigating the risks of regulatory capture in supervisory work. The high degree of openness of the states' regulatory processes, including those undertaken through the NAIC (see below), is seen as mitigating the risk of undue industry influence over regulation.</p> <p>Within the <u>FRB</u>, the Division of Supervision and Regulation has supervisory oversight responsibilities, including for BHCs, SLHCs and NBFCs. Supervisory work is undertaken by Federal Reserve Banks under delegated authority from the FRB and coordinated, in the</p>

case of NBFs, by the Operating Committee of the FRB's Large Institution Supervision Coordinating Committee (LISCC). Immediate decisions can be and are taken in case of emergency. Regulatory standards are developed by the FRB itself, also within the Division of Supervision and Regulation.

The FRB is independent from the legislative and executive branches of the U.S. government, but accountable to Congress, to whom it submits an annual report (in addition to testifying at hearings etc.) There is no provision for executive overrides of FRB decisions. The Government Accountability Office (GAO) has authority to review the FRB and conducts a number of reviews each year to look at aspects of its activities, including regulation and supervision. In addition, the Office of Inspector General (OIG) for the FRB conducts internal audits of the agency.

(This assessment has not reviewed the independence and accountability of the Federal Reserve Banks—for which, see the Detailed Assessment of Observance of the Basel Core Principles and other Basel Core Principles for Effective Banking Supervision–BCP2).

### **Appointment and Dismissal**

There are explicit procedures for the appointment of the state commissioners. Of the 56, 12 are elected by popular vote. Most are appointed by the state governor, with the advice and consent of the state senate, to hold office for a fixed term or, in some cases, until the term of office of the appointing governor expires. Approximately one-third of commissioners, whether elected or appointed, serve a fixed term. Many are appointed to serve at the pleasure of the governor or appointing body. Some commissioners have state executive responsibilities in addition to insurance supervision.

State laws set out the qualifications required to become commissioner including for some the requirement that such person be competent and fully qualified to perform the duties of the office. Additionally, states may require that the commissioner may not have any personal financial interest in the insurance industry. State laws generally set out grounds for removal from office. Reasons for dismissal may be published in connection with an investigation or potential prosecution (when dismissal is for violation of state law), but publication is not otherwise required.

One state, New Mexico, has recently amended its legislation such that future Superintendents of Insurance will be selected by a bipartisan committee (with members appointed by the legislature and governor) for a four-year term with provision for dismissal solely for incompetence or malfeasance. (*New Mexico Code, Article 59A-2-2*).

Members of the FRB are appointed by the President and confirmed by the U.S. Senate to a full or to an unexpired portion of a 14-year term. On appointment by the President and with the advice and consent of the U.S. Senate, one of the members is designated as Chair, and another Vice Chairman, for a four-year term. There is no expectation that Governors will resign at the conclusion of the term of the President who appointed them. Members of the FRB can be removed for cause by the President, although there is no requirement in law for reasons for dismissal to be published. (*12 U.S.C. § 242*).

### **Financing and Allocation of Resources**

All state insurance departments are subject to state budgetary authority. Spending limits are set by the state legislature, taking into account budget proposals submitted by insurance departments themselves. Insurance departments also determine fees, assessments and other income levied on insurance companies. Expenditure is generally financed either directly from the state general budget or from the share of total fees,

assessments and other income levied which is retained by the insurance department. (In aggregate, departments currently raise fees and assessments twice the value of their total expenditure budget).

However, funding arrangements vary. Some insurance departments (those with a “dedicated funding system”) have flexibility to retain any surplus of dedicated revenues (from fees, assessments etc.) over actual expenditure. The charging of fees on insurance companies for examination work gives some flexibility to finance examination work.

In general, however, insurance departments are financially dependent on state legislatures. Legislatures can and do direct spending to particular areas of work, although in general departments are free to allocate most resources according to their own priorities.

The FRB is self-funded in respect of all its operations including regulation and supervision. Its income derives primarily from interest on government securities acquired in open market operations. It has discretion to allocate its resources in accordance with its mandate and objectives and the risks which it perceives.

### **Transparency and Review of Requirements and Procedures**

In relation to the states, all laws, regulations and rules are subject to a public approval process, at the legislative or administrative rule-making level. Where legislation authorizes the regulator itself to make rules, state law on administrative procedure governs the process. States publish proposed rules or regulations in the state register and/or website, seek public comments and may hold public hearings prior to implementation or adoption.

NAIC model laws and regulations are also subject to a highly transparent process of development, during which drafts are exposed for comment and issues discussed at NAIC national meetings. There is also a continuous process of regulatory development through the NAIC process (in recent years, to take account of the financial crisis) in addition to reviews of requirements at the level of the individual states.

State regulators and the NAIC publish extensive information on the insurance sector and its regulation, including:

- financial information about the sector in each state and nationally, including making available insurance companies’ regular filings and studies on specific issues;
- model laws and regulations (since the 2010 FSAP, these have been made available without charge);
- information on the authority and responsibilities of insurance departments; and
- departments’ annual reports and strategic plans and an NAIC annual report.

The NAIC also produces an annual publication, the Insurance Department Resources Report, which contains state-by-state and national information on the insurance sector and the resources available to insurance regulators.

Regulatory enforcement actions taken by state regulators in respect of individual insurance companies and producers are typically published and are subject to administrative appeal processes and judicial review, as provided for in individual model laws. Companies may also appeal against findings in draft examination reports. Initial appeals are normally to the commissioner but may be heard by other senior staff in the department (not the relevant analyst or examiner); or an officer may be designated in

<p>law to hear appeals. Beyond that, cases may be litigated through the courts.</p> <p>In particular for troubled companies, laws give insurers a right to a hearing on the regulator’s action and prescribe judicial review of any order or decision of a commissioner made under the relevant law. (<i>Model Regulation to Define Standards and Commissioner’s Authority for Companies Deemed to be in Hazardous Financial Condition, sections 4 C and 5</i>)</p> <p>Separate procedures apply in the case of receiverships, where laws provide for appeal to the court overseeing the receivership. Once a receivership decision is confirmed by the court, departments are not required to await the outcome of an appeal before appointing a special deputy receiver to manage the company. (<i>Insurer Receivership Model Act, section 205</i>).</p> <p>State regulators can and do allow individual companies to petition the regulator individually. “Permitted practices” are accounting treatments specifically requested by a company that depart from NAIC SAP and state prescribed accounting practices. The domiciliary state grants approval to use such a practice, but must provide advance notice to all other states in which the insurer is licensed, giving details. Insurers have to publish permitted practices, including the amount of the benefit, in their quarterly and annual financial statements. The granting of permitted practices is recognized by the accreditation program.</p> <p>The <u>FRB</u> publishes extensive information about its role and responsibilities as well as its regulations, which are subject to public consultation and available on its website. Guidance on its expectations of supervised firms are set out in Supervision and Regulation (SR) letters. It also publishes examination material. Requirements in relation to SLHCs are set out in SR 11-11 (issued after the FRB assumed responsibility for SLHCs) and SR 14-9. It has also published a high level framework for its supervisory program for NBFCs in SR 12-17. Neither set of requirements is, however, fully developed as yet in relation to the particular regulatory and supervisory issues relating to insurance business.</p> <p>FRB policy is to review and revise regulations and guidance on a regular basis. Its policy is also to publish information on its approach to supervision, including of companies involved in insurance business. Some analytical papers have already been published, but the FRB’s approach is developing at this early stage of the SLHC and NBFCs regimes. It publishes research and analysis on insurance sector issues.</p> <p>The FRB has processes for handling appeals by regulated companies. Supervisory determinations made during the examination and inspection process may be appealed to independent FRB staff. Where the FRB issues a formal order, the subjects may contest the matter in an administrative proceeding before the FRB and if dissatisfied with the final decision issued by the FRB, may pursue an appeal in the federal courts.</p> <p><b>Confidentiality of Information, Legal Protection and Code of Conduct</b></p> <p>Government administration in the United States is subject to a strong presumption that the public should have access to information absent specific provisions requiring information to be maintained confidentially. <u>State</u> insurance laws recognize that certain information should be maintained as confidential and specify the types of information that are to be treated as confidential. They generally provide, for example, that examination papers and related information, risk-based capital information, and holding company act reports and examination information are confidential. State laws on freedom of information also refer to information to be considered confidential by law</p>
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and not subject to subpoena.

In some states, general laws on protection of confidential information may be supplemented by employment law provisions, contractual obligations or the internal rules of the state supervisor. State law generally places the obligation directly on employees not to divulge confidential information obtained in the performance of their duties. Wrongful disclosure may be subject to administrative, civil and criminal penalties under state law. Requirements to protect confidential information are included in contractual agreements, when staffs are hired on contract.

The accreditation program addresses the protection of confidential information through the inclusion of relevant laws (for example, the Model Law on Examinations) among accreditation standards and by assessing the ability of insurance departments to maintain the confidentiality of information received from other authorities.

The NAIC-sponsored Master Information-Sharing and Confidentiality Agreement (MISCA) signed by all states, also commits them to keeping information confidential. In addition, seven states so far are signatories to the IAIS Multilateral Memorandum of Understanding (MMoU), and others have applications pending. State insurance departments are parties to various memoranda of understanding with international regulators, either on a bilateral basis or through a supervisory college (see ICPs 3 and 25).

In practice, while state laws vary in form, all states are able to protect information received from other government agencies, including other state regulators and international regulators. The NAIC and state insurance departments visited were able to evidence cases where requests under freedom of information or open records laws and subpoenas had not led to the disclosure of confidential information in practice.

Staffs have legal protection from lawsuits resulting from specific actions taken in the course of regulatory work. For example, the Model Law on Examination (#390) provides for immunity from liability for statements made or conduct performed in good faith while carrying out the provisions of the Act. Insurance departments protect staff from the costs of defending their actions, where this is necessary.

States also rely on the doctrine of “sovereign immunity” that limits claims that can be brought against state governments and their employees acting as agents of the state. The NAIC and state insurance departments visited evidenced cases where suits brought against them had been unsuccessful.

States have ethics laws and codes of conduct for employees (in some cases contained in agreements with unions). These address standards of professional conduct, including acceptance of gifts and hospitality, disclosure of potential conflicts of interest and outside employment. Codes of conduct apply to contractual staff used by insurance departments through the contractual agreements.

FRB employees are subject to laws making it a crime for an employee of the U.S. federal government to divulge, disclose, or make known in any manner trade secrets or other confidential business information collected in the course of employment or official duties. The FRB has adopted rules on the treatment of confidential information, setting out, among other things, the procedures for limited release of exempt and confidential supervisory information and the procedures for protecting confidential information. (*18 U.S.C. § 1905 & 12 CFR Part 261*).

The FRB is subject to sovereign immunity. While lawsuits against it cannot be pursued



without specific statutory authorization, lawsuits are permitted against employees for acts and/or omissions that cause injuries while acting within the scope of their employment under the Federal Tort Claims Act. In such a case, the United States would substitute itself as the defendant upon the Attorney General's certification that an employee was acting within the scope of his office or employment at the time of the incident giving rise to the tort claim. Moreover, an exception to the relevant act protects employees from lawsuits involving the execution of a statute or regulation or the exercise or failure to exercise a discretionary function, whether or not the employee abused the discretion involved. (28 U.S.C. § 2679(d)(2)).

### **Resources**

State insurance departments experienced significant reductions in resources during the financial crisis, but aggregate resources have been held steady in recent years. Total budgets for all the departments are US\$1.3 billion in 2015, similar to the level of 2009, and staff totaled 11,529 at year-end 2013.

Many contract staff and staff from other agencies are also used. (Detailed data on staff numbers, grades and pay ranges by state are published annually in the NAIC Insurance Department Resources Report.) In addition, the NAIC employs around 470 staff, many of them in IT support for NAIC databases.

The NAIC accreditation program assesses whether insurance departments have adequate resources to meet regulatory priorities. Insurance departments are expected to hire, train and maintain sufficient staff with high professional standards and expertise, including actuarial, and to hire external specialists when appropriate.

The standards address professional development, educational and experience requirements, and the ability to attract and retain qualified personnel. Insurance departments are authorized by law to retain outside experts (e.g., for evaluation of complex financial transactions or actuarial reserve levels) with the costs to be borne by the insurer.

In addition to insurance departments' own training programs, the NAIC offers regular training. Many states also draw on NAIC staff to offer financial examination and analysis support. States have also established an Examination Peer Review program, organized by the NAIC, to assess and improve examination practices. A similar program is under development for Own Risk Solvency Assessment (ORSA) filings (see ICP16).

State insurance departments' staff remuneration is generally linked to the general pay grades for state employees, although some states have limited flexibility to pay above normal rates to meet particular needs. This constraint has not prevented departments from maintaining full or near-full staff complements (staff turnover is relatively low and experience levels high by international standards), while specialist expertise can be and is sourced at cost and charged to insurance companies.

Some departments have already obtained additional financing for the challenges of staffing for ORSA and other developments.

Recruitment of younger qualified staff, and the development of staff skills to handle the demands of risk-focused supervision (including ORSA work) and avoiding overreliance on external experts, have been identified as key challenges. The states' complement of actuaries is concentrated in the larger states and some have no actuaries. Market conduct regulation is staffed to a lower level than financial regulation in all states, with

	<p>limited availability of market conduct analysts in particular.</p> <p>As the FRB is wholly self-funded, it is able to set a budget and raise resources necessary to meet its responsibilities. It maintains evaluation of hiring and retention programs to attract and retain staffs that have the necessary critical skills. The FRB has annual training budgets and insists that staff undergo adequate and relevant training. The FRB is able, and does occasionally hire or contract with outside experts.</p> <p>The FRB has been growing its staff complement in the insurance area, drawing on staff from other FRB functions, including banking supervision, from state insurance departments and from the insurance sector. This process is continuing and staffing levels, in regulation and supervision (at the FRB) and supervision (at the Federal Reserve Banks) are currently some way below targeted levels, in terms of numbers and expertise, including actuarial.</p>
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>State insurance regulators generally have a high degree of day-to-day operational independence and accountability. They operate within a highly transparent framework, with an emphasis on open government, but are also able to protect confidential information received from firms and from other authorities. Legal protection of agencies and staff is adequate.</p> <p>There remain risks to independence in state governance arrangements. While the vesting of regulatory powers in the commissioner helps protect departments' operational independence, the arrangements in many states for appointment and dismissal of commissioners expose state supervision to potential political influence. Elected commissioners may be subject to the pressures of the electoral cycle.</p> <p>The high dependence on state legislatures in respect of large amounts of regulatory legislation and for budgetary resources exposes departments both to political influence and to potential budgetary pressures. These risks are mitigated but not eliminated by NAIC processes, including the accreditation program.</p> <p>While states' financial resources appear broadly adequate for current work programs, levels of skills and expertise require development, as the technical demands of supervisory work change in line with regulatory reform and as market conduct regulation develops. Some departments are dependent on contractual staff, in some cases outsourcing almost all financial and market conduct examination work on major firms. The application of statewide remuneration policies constrains departments' ability to hire specialist skills.</p> <p>The NAIC accreditation program has served state regulation well, enhancing uniformity and effectiveness of financial regulation. The NAIC could now extend its scope, for example to the regulation of captives, market conduct and intermediary regulation. They could also introduce an increased focus on the quality of supervisory judgments (much of the focus of the accreditation reviews is on whether required processes have been followed), building on its valuable initiative to establish a (voluntary) Examination Peer Review program which reviews particular company examinations.</p> <p>In addition to its need to build expertise in insurance regulation and supervision, the FRB requires understanding of insurance issues at senior levels in order to ensure that insurance issues are subject to appropriate levels of management time and attention.</p>

	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• states reform arrangements for the appointment and dismissal of commissioners, providing for fixed terms, with dismissal only for prescribed causes and with publication of reasons;</li> <li>• state governments increase the independence of insurance departments in relation to resourcing, enabling them to determine budgets, set and retain relevant fees and assessment income to finance their work and employ appropriate staff as necessary to meet their objectives, subject to continued accountability to state legislatures;</li> <li>• the NAIC review the scope and operation of the accreditation program, including the potential value of an element of external assessment and a quality assurance element to accreditation work; and</li> <li>• the FRB continue to increase its insurance expertise (particularly in the area of actuarial methods, insurance accounting and underwriting risk), including in senior positions, to ensure the effectiveness of its insurance group supervisory work.</li> </ul>
<p><b>ICP 3</b></p>	<p><b>Information Exchange and Confidentiality Requirements</b></p> <p>The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.</p>
<p>Description</p>	<p><b>Legal authority</b></p> <p><u>State</u> insurance regulators have authority to obtain information from regulated insurers upon request or at specific times; hold hearings and compel the attendance of witnesses; command the production of documents; and examine the insurer at any time and at designated intervals. Insurers must regularly submit information related to the financial condition and business operations of the entity and its affiliates, whether regulated or non-regulated, including annual and quarterly financial statements and risk-based capital reports.</p> <p>Key powers in respect to groups are in the NAIC Insurance Holding Company System Regulatory Act, implementation of the current version of which is an accreditation standard. As mentioned under ICP1, the authority to obtain consolidated financial reports and require an enterprise risk report (Form F) for the full holding company structure will be required under the accreditation program from 2016.</p> <p>State insurance laws provide for the commissioner to share confidential information with other authorities, either by general authorization or, more often, through authorization in laws for sharing specific types of information (for example, examination and holding company information).</p> <p>The authorities with which the commissioner is authorized to share information include other state, federal and international regulators and state, federal and international law enforcement authorities. (<i>NAIC Model Law on Examinations, No 390, section 5F(3)(a); Insurance Holding Company System Regulatory Act, No 440, section 8C</i>).</p> <p>The existence of an agreement or MoU is not an absolute prerequisite for information sharing by states nor is strict reciprocity, but MoUs are used in practice. State insurance laws generally provide that, as a condition of sharing confidential information with other governmental entities, the state insurance regulator enter into a written agreement for that purpose and the receiving party must have the authority to maintain the</p>

confidentiality of the information provided. (*NAIC Model Law on Examinations, No 390, section 5F(3)(a); Insurance Holding Company System Regulatory Act, No 440, section 8C*).

Under the NAIC-sponsored Master Information-Sharing and Confidentiality Agreement (MISCA), state regulators are required to demonstrate a proper regulatory purpose in requesting information from another regulator and that they possess legal authority to maintain the confidentiality of information being requested. The MISCA sets out a detailed procedure for dealing with information requests between states, committing them to timely responses, for example, and informing the states sharing confidential information if there is a third party or judicial request for disclosure.

Information sharing agreements with other regulatory bodies, including federal and international supervisors, are regularly based on the MISCA and impose similar requirements. There is a template MoU that the NAIC developed with the European body (now EIOPA), which states can and do use as a basis for establishing MoUs with foreign regulators.

MoUs set out the framework and establish expectations for information exchanges, including that the requesting authority is subject to requirements to protect confidential information, limitations on use of confidential information; and procedures for how information received may be forwarded to another authority (subject to the consent of the authority which originated the information). (*MISCA, paragraph 4*).

MoUs also commit state regulators to notify an authority from which it has received information which is subject to a subpoena or other legally enforceable demand for disclosure and to use all reasonable legal means to resist such a demand. (*MISCA, paragraph 4*).

The current body of states' MoUs reflects the key international relationships in respect of major global groups with operations in the United States and major U.S. companies' operations abroad. MoUs are also in place between some states for which global reinsurance providers are of particular importance and the countries where the global reinsurance companies are located.

Seven states are so far signatories to the IAIS Multilateral Memorandum of Understanding (MMoU), although 7 more have applications pending and more are considering applying.

State insurance regulators also have information-sharing agreements with the FRB, the OCC and the FDIC. The NAIC has a MoU to provide information to the Treasury Department, including FIO and the Office of Financial Regulation (OFR). State insurance departments are also parties to various memoranda of understanding with international regulators, either on a bilateral basis or through a supervisory college.

The FRB has authority under the Dodd-Frank Act to require NBFCs and SLHCs to submit reports concerning the financial condition of the company and subsidiaries, among other items. The FRB may require NBFCs and SLHCs to supply copies of reports and supervisory information which the firm has provided to other federal or state regulators. (*12 U.S.C. § 5361(a)(1) and 12 U.S.C. § 5361(a)(3)*).

The FRB may also request information that facilitates the FRB's examination of an NBFC and has authority under the BHC Act and HOLA to require BHCs and SLHCs to submit a broad range of information, including annual and quarterly reports. Where necessary and appropriate, the FRB may request supervisory information concerning non-regulated subsidiaries of regulated entities. (*12 U.S.C. § 5361(b). U.S.C. § 1844(c), 12 U.S.C. §*

<p><i>1467a(b)</i>.</p> <p>The FRB has legal authority to share information with other banking and financial system supervisors, subject to the recipient maintaining the confidentiality of the information and a requirement that the information be used for lawful supervisory purposes. (<i>12 U.S.C. §§ 1817(a)(2)(A) and (C); 12 U.S.C. § 3412(e)</i>).</p> <p>The FRB has entered into bilateral formal information-sharing and cooperation agreements with all 50 states and the District of Columbia insurance departments and with 24 foreign supervisors, including some with responsibilities for insurance supervision, and additional arrangements are in process.</p> <p>As a member of the FSOC, the FRB is a signatory to the FSOC’s multilateral MoU regarding the treatment of non-public information shared among its member agencies. The FSOC has also entered into MoUs with 19 state insurance regulators.</p> <p>The existence of an agreement or MoU is not a prerequisite for information sharing by the FRB nor is strict reciprocity. If there is no agreement or MoU, the FRB can still share information with other regulators but it confirms that the request meets the statutory and regulatory requirements, seeking assurances that the information will be used only for lawful supervisory purposes and will be kept confidential. The FRB assesses each request for information from another supervisor on a case-by-case basis.</p> <p><b>Exchange of information in practice</b></p> <p><u>State</u> regulators exchange supervisory information on a regular basis – with other state insurance regulators under the terms of the NAIC-sponsored MISCA. States respond to ad hoc or occasional requests for information. More intensive exchanges are between departments with responsibility for the same insurance company or group, in NAIC fora such as the FAWG and regular NAIC meetings, and in the context of supervisory action taken on troubled companies.</p> <p>States’ sharing of information with international regulators has increased substantially since the 2010 FSAP. While exchanges take place on an ad hoc basis, the most intensive exchanges now take place in the context of the newly-established supervisory colleges (see ICP25).</p> <p>Since 2011 for SLHCs and 2013 for NBFCs, state regulators have needed to exchange information and cooperate with the FRB in respect of the 15 SLHCs with insurance business and the two insurance NBFCs. The extent of exchange and cooperation is generally good, but was reported to the assessors as varying by company and team. State regulators and the NAIC also need to share information and cooperate with the FIO. Again, the extent and quality of exchanges varies. However, in all cases, exchanges of confidential information necessary for effective supervision appear to be taking place.</p> <p>There is also cooperation with federal authorities responsible for the various government programs—Treasury Department (TRIP), FEMA (flood insurance), Department of Agriculture (crop insurance), and the Department of Labor (workers compensation).</p> <p>Information-sharing is covered by the NAIC accreditation program (exchanges with U.S. and foreign regulators are expected to be part of the states’ regulatory practices and procedures for multi-state insurance companies).</p> <p>The <u>FRB</u> exchanges supervisory information when requested using formal and informal mechanisms. As a holding company rather than a legal entity regulator in relation to U.S. insurance supervision, the FRB is not involved in many of the routine requests for and</p>
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	<p>exchanges of information about individual insurance companies. It does exchange information with state insurance regulators and foreign regulators under bilateral arrangements and through the colleges of supervisors, where applicable.</p> <p><b>FIO</b></p> <p>FIO needs to be able to receive and share confidential information in relation to its responsibilities under the Dodd-Frank Act (see ICP1):</p> <ul style="list-style-type: none"> <li>• The FIO has powers to collect data and information from insurers; to enter into information-sharing agreements; and to require by subpoena the production of data or information from insurers and affiliates. However, the FIO must first coordinate with other federal or state authorities to determine that the information it proposes to collect is not available from other agencies or from public sources. (31 U.S.C. § 313(e));</li> <li>• FIO may also share data or information it obtains with state insurance regulators, individually or collectively, through an information-sharing agreement (one is in place with the NAIC).</li> <li>• As a member of the FSOC, FIO is a signatory to the FSOC’s multilateral MoU.</li> </ul> <p>The Dodd-Frank Act provides that the confidential status of information provided to FIO, whether by operation of law or by agreement, continues after that information is provided to FIO. (31 U.S.C. § 313(e)(5)(B))</p> <p>FIO has not yet collected data from insurance companies using formal powers.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>The extent of information exchange involving U.S. supervisors has increased in recent years, facilitated by NAIC processes (as well as the accreditation program), the development of an extensive network of MoUs and the establishment of international supervisory colleges. States have begun to apply and in seven cases have become signatories to the IAIS MMoU.</p> <p>Increased trust appears also to have been developing between supervisors, within the United States and with foreign regulators has been developing, facilitated by greater understanding and confidence in the ability of U.S. supervisors and their foreign counterparts to protect confidential information. This process has further to go and needs to be actively managed—for example by supervisors being proactive more often in sharing information, while there is also scope for broader cooperation and collaboration amongst regulators (see ICP25).</p> <p>It is recommended that states and the FRB review their internal processes and procedures, including staff training, to ensure that supervisors understand the importance of sharing information, including proactive sharing, taking into account the need to ensure confidentiality.</p>
<p><b>ICP 4</b></p>	<p><b>Licensing</b></p> <p>A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.</p>

<p>Description</p>	<p>States regulators are responsible for licensing of insurers and there is no responsibility assigned to FIO or the FRB. Licensing requirements imposed by state regulators are broadly uniform as is described as follows. However, in practical and interpretation level, there seem to have inconsistency and divergence among the states.</p> <p><b>Regulatory authority</b></p> <p>The insurance business that requires licensing is defined, for each state, in the state insurance codes, in terms of lines of business that are permitted to be undertaken.</p> <p>Each insurer has to be licensed in each state where it wants to write business. The exceptions are surplus lines business (those mainly commercial lines which are hard to insure in a particular state, which can be written by a company licensed in another state free of some of the regulatory requirements and coverage by guaranty funds) and reinsurance, where provided the company has a license in one state, it can undertake business in other states without a separate license (it may be subject to other requirements of the host state in which it is writing business).</p> <p>The NAIC has accreditation standards related to a state insurance department’s review of an application for an initial license which require the department to have documented licensing procedures that include a review and/or analysis of key pieces of information included in a primary license application.</p> <p>To create a national uniform application, the Uniform Certificate of Authority Application (UCAA) was created by the NAIC, and all states (and Puerto Rico) accept the UCAA with minor variations based on state laws. The application can be used for all lines of insurance business except that done by a Health Maintenance Organization (HMO). A company may need additional authorizations beyond receiving a Certificate of Authority to actually operate a business in some states. Specific state licensing requirements are generally available on the NAIC/UCAA website or the state web sites.</p> <p>The scope of the licensing requirement is broad and covers most of what would generally be regarded as insurance business. There are no uniform exclusions across states, but typical exclusions are product warranties, certain pet insurance and prepaid funeral plans. In addition, some states exempt entities owned by state governments and certain charitable organizations.</p> <p><b>Corporate Forms</b></p> <p>Life insurance must be undertaken in a different corporate entity from property and casualty business (there is one company which still operates as a composite, having been subject to grandfathering when the new approach was introduced). Insurance companies may be established as corporate or as mutual companies.</p> <p><b>Cooperation with Foreign Regulators</b></p> <p>In case of application of a foreign insurer, state regulators consult with its home supervisor before the issuance of a license, as is described in the Company Licensing Best Practices Handbook.</p> <p><b>Suitability of Board and Senior Management</b></p> <p>The suitability of the applicant’s Board members and Senior Management is considered at the individual level and collective level (see ICP 5). A license applicant is required to submit business characteristic report for all officers, directors, key managerial personnel and individuals with a 10 percent or more beneficial ownership in the applicant and the</p>
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applicant's ultimate controlling parent (see ICP 5). Suitability of Significant Owners and Key Persons in Control Functions is considered when assessing applications. State regulators investigate litigation, criminal Uniform Commercial Code and bankruptcy records in respect of those officers.

#### **Absolute minimum capital requirement**

The level of surplus required is determined by the state regulator after considering the applicant's product line, operating record and financial condition. Requirements in state law generally refer to minimum ongoing requirements—for example, that applicants meet the requirements for surplus funds set out in the general requirements. There may be certain overriding criteria that are less objective in nature—for example enabling the commissioner to refuse to issue or renew a license if such refusal is judged to promote the interests of the people of the state. However, the required amount and quality of capital differ significantly from state to state even for the same line of business. While many states require several millions of paid-in capital stock plus extra capital depending on the business plan, other states require significantly smaller amounts and lower quality capital which may give rise to regulatory arbitrage.

#### **Sound Business and Financial Plans**

The plan of operation portion of the business profile which applicants must submit presents, in detail, the product lines currently sold and planned by the applicant, the applicant's marketing plan, a description of current and expected competition (both regionally and nationally), and a discussion of how each state in which admission has been requested fits into that plan. A verification form and brief questionnaire must accompany the applicant's plan of operation. The Company Licensing Best Practices Handbook also provides guidance on how to analyze a submitted business plan. However, the description does not include concrete methods of analysis, which may lead to inconsistent approaches in practice. Proper analysis is subject to validation in the accreditation process. However, the documentation of some states may not be sufficient for the on-site accreditation reviewer to be able to check the appropriate analysis of the business and financial plan.

#### **Review of Group Structure**

State insurance laws generally impose various restrictions on a licensed insurer's ownership by, or affiliation with, other financial or non-financial companies provided the owner meets criteria through the regulatory approval process. The Insurance Holding Company System Regulatory Act requires an insurer to invest no more than 10 percent of their assets into subsidiaries. In addition, state law generally prevents an insurer from setting up subsidiaries and affiliates for investment activities. Applicants who are members of a holding company system are required to include a comprehensive debt-to-equity ratio statement in the group-wide basis. A summary of the applicant's reinsurance program, listing all reinsurance agreements and providing a basic explanation of each agreement, must also be included in the application.

#### **Timeliness of Review**

The UCAA manual and the best practice handbook describe target goals for deciding on applications (90 days for a primary application and 60 days where the company is already licensed in one state and is seeking to expand business into another). However, in both cases, more time is taken if additional information is needed to complete the review of an application. While some states do not have specific provisions on target



	<p>days, the accreditation program includes the 90 days goal.</p> <p><b>Scope and Condition of License</b></p> <p>Licenses are granted for specified business lines and an additional application is required before the insurer may add a new business line. State regulators can impose conditions upon licensing; however, it is uncommon to issue a license with such conditions.</p>
Assessment	Largely Observed
Comments	<p>The UCAA process and accreditation standard for licensing (which became part of the accreditation program in 2012) cover core requirements and contribute to the consistency of licensing requirements across states. However, inconsistency of requirements and practices remain a perceived opportunity for arbitrage opportunities. With regard to capital, however, once a company is operating and writing business, RBC becomes more relevant as it is the higher standard.</p> <p>Guidance on business model analysis exists and the accreditation process ought to analyse the appropriateness of its application in practice through on-site reviews. However, documentation about business model assessment (such as peer comparison of cost structures, etc.) may not enable the accreditation process to validate appropriate and consistent application among states and across business lines. Differences between state requirements on licensing could encourage companies to choose for their domestic regulator a state with less onerous requirements and to “redomesticate” as individual state requirements or their business needs develop. The number of redomestications has decreased from an average of 50 per year in 2006–8 to 40 per year in 2009–2013 (31 in 2013). In practice, departments and the NAIC staff appear alert to these risks and, for example in relation to redomestication applications, consult with the previous domestic state on the circumstances of the application before agreeing to a license. The number of redomestications is monitored.</p> <p>It is recommended that states improve consistency of the licensing requirements among the states both at high level (such as absolute minimum capital level and scope of exemption of licensing) and practical interpretation level (through better documentation of analysis and more detailed accreditation review work).</p>
<b>ICP 5</b>	<p><b>Suitability of Persons</b></p> <p>The supervisor requires Board Members, Senior Management, Key Persons in Control Functions<sup>11</sup> and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.</p>
Description	<p><b>Management and Key Control Functions</b></p> <p>The primary processes to ensure the suitability of persons include the company licensing (refer to ICP 4), off-site monitoring and on-site inspection processes and are therefore conducted by state regulators.</p>

<sup>11</sup> Control functions include risk management, compliance, actuarial and internal audit functions.

The states' assessment focuses on the independence, experience, background and ethics of these individuals and functions. Individuals (such as senior managers and staff performing key control functions) are interviewed to assess suitability during on-site inspections. If deficiencies are identified, the examination team makes recommendations for improvements to the insurer and adjusts its ongoing solvency monitoring of the insurer accordingly.

Through the use of tools such as increased reporting requirements or more frequent examinations, regulators aim to provide an incentive for the insurer to make changes in those areas where unsuitable individuals are identified. There is no approval requirement for Board Members, Senior Management and Key Persons in Control Functions. In addition, although detail descriptions cover fitness, there is no detailed provision in law defining the basis on which an individual will be regarded as proper such as a requirement for competence and integrity.

Title 18 U.S.C. § 1033 of the U.S. Code addresses crimes by or affecting persons engaged in the business of insurance. This law bars those convicted of various crimes from working for an insurer.

With respect to the formation of SLHCs, the Home Owners' Loan Act (HOLA) require the FRB to consider the managerial resources of any company that proposes to become SLHC.

### **Significant Owners**

The Insurance Holding Company System Regulatory Act (#440) stipulates the requirements regarding significant owners. It also defines control in terms of "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person." In addition, "Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10 percent) or more of the voting securities of any other person."

Although there are some differences in the definition of significant owners among states, all states and the District of Columbia have adopted a figure of 10 percent or lower as the threshold. The commissioner can disapprove of the acquisition if the financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interest of its policyholders.

### **Ongoing Suitability**

Insurers are required to notify regulators of changes in officers, directors and key managerial personnel and file new biographical affidavits upon request. After such changes are reported, supervisors do then request biographical affidavits for newly appointed officers, directors and other key management personnel.

There is no specific requirement on companies to notify the department when they become aware of issues in relation to the fitness of a key functionary. However, the suitability of persons is reviewed during the financial examination with the focus being on the background and experience of individuals. This is typically done through interviews of senior management and board members, which inform a suitability assessment.

Information regarding the financial condition of owners is filed with the department as part of the Form B filing requirements outlined in the Model Holding Company

	<p>Regulation (#450) and subject to review and analysis.</p> <p><b>Regulatory Actions</b></p> <p>The Hazardous Financial Condition Model Regulation (#385) includes a suitability standard that can be enforced by requiring the insurer to “correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the commissioner.” This particular standard has been adopted by a majority of state insurance departments and is included as a required element of the NAIC accreditation program.</p> <p>Under the same model regulation, the supervisor can consider whether the management of an insurer, including officers, directors or any other person who directly or indirectly controls the operation of the insurer, fails to possess and demonstrate the competence, fitness and reputation deemed necessary to service the insurer in such position. However, dismissal and replacement of individual persons because of the lack of his/her properness has not been required in practice.</p> <p><b>Coordination with other authorities</b></p> <p>Various states have entered into MoUs to allow communication with other jurisdictions (see ICP25). Communication between states also occurs regularly through the Financial Analysis Working Group (FAWG) process in relation to suitability matters. States are responsive to suitability enquiries from non-U.S. jurisdictions when received.</p> <p><b>Ongoing Regulatory Initiatives:</b></p> <p>NAIC has developed additional standards for regulator use in these areas. The new Corporate Governance Annual Disclosure Model Act and Corporate Governance Annual Disclosure Model Regulation) will require insurers to report to regulators detailed information on governance practices including suitability of persons on an annual basis. As this information is intended to be reported to regulators starting as early as 2016, additional guidance will be added to regulatory handbooks and manuals to explain how this information may be used in the assessment process.</p> <p>The Corporate Governance Annual Disclosure Model Act also provides that insurers be required to provide information regarding internal suitability standards that the insurer has developed and disclose changes in the suitability status of those listed above.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>Although there is some material in legislation, states rely to a high degree on “onsite examination” (mostly on five years cycle, although there is other supervisory work in the interim) to identify and remedy issues with the suitability (in particular properness) of key individuals. In addition, existing examination practices tend to focus more on compliance (thus more on fitness), and the competence and integrity of key individuals are not well focused on or at least sufficiently documented.</p> <p>Lack of powers, such as ongoing approval process of Board, Senior Management and Key Person in Control Functions, and other alternative mechanisms, such as disclosure, makes it difficult for state regulators to take formal regulatory action rather than applying moral suasions as properness of key individuals tend to be judgemental and strong regulatory enforcement actions are not appropriate in many cases.</p> <p>States are recommended to adopt and implement the Corporate Governance Annual</p>

	<p>Disclosure Model Act (refer to ICP 7 and 8 for more detail), and related regulation and handbooks promptly, which will provide additional market pressure through disclosure and annual reporting to the supervisors about detailed information on governance practices including suitability of persons. This will improve the effectiveness of examination and the properness of Board, Senior Management and Key Persons in Control Functions. States are also recommended to require examiners and supervisors to state more clearly their observations of the properness of key individuals at least in their internal documentation, so that appropriate regulatory actions can be taken and followed up to improve the situation.</p> <p>(This ICP is closely related to ICPs 7 (Corporate Governance) and 8 (Risk Management and Internal Controls). Some issues of relevance to ICP 5 and material to its rating are reflected in the assessment and the rating of ICP 7.)</p>
<p><b>ICP 6</b></p>	<p><b>Changes in Control and Portfolio Transfers</b></p> <p>Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.</p>
<p>Description</p>	<p><b>Definition of Control</b></p> <p>All states and the District of Columbia have adopted substantially similar language from the Insurance Holding Company System Regulatory Act and its related Regulation regarding changes of control for licensed insurers. The Model Act clearly defines “control” as “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person.” In addition, “Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10 percent) or more of the voting securities of any other person.”</p> <p>The Model Holding Company Act requires potential controlling owners to obtain regulatory approval for changes in control. The Form A Statement of the related regulation provides for extensive disclosure and attestation regarding the acquiring party’s intention to control and ability to meet regulatory standards for acquiring such control.</p> <p>The FRB also has clear definition of Control in the context of SLHC supervision, which is defined as “the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25 per centum or more of any class of voting securities of an insured depository institution”.</p> <p><b>Notification of Changes in Control</b></p> <p>The Model Holding Company Act requires that the domestic state insurance departments must be notified of major transactions with affiliated entities which could include material portfolio transfers between related parties. Assumption reinsurance and bulk reinsurance statutes establish thresholds by which material transfers of all or most of an insurer’s business either in total or within a specific line of business are subject to review and approval.</p> <p>The supervisor approves any significant increase above the predetermined control levels, whether obtained individually or in association with others. Under the Model Holding</p>

Company Act, any controlling person seeking to divest its controlling interest in the insurer must file a confidential notice of its proposed divestiture at least 30 days prior to the cessation of control.

### **Review of Change in Ownership Application**

The Model Holding Company Act (section 3B) requires the acquiring party to provide significant information, under oath or affirmation, including but not limited to listing all offices and positions held during the past five years, any conviction of crimes, source, nature and amount of the consideration used, and other pertinent information. The Act also provides State Regulators to require an annual filling of information related the ultimate controlling party.

Under the Model Holding Company Act (Section 3D(1)(a)), the supervisor will not approve the acquisition of control if the applicant (after the change of control) would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is seeking approval. The Model Holding Company Act (Section 3D(1)(c)) also provides approval power to the supervisor on the acquisition of control if the financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders.

The Model Holding Company Act provides that regulators can deny an application for change of control for any of the following reasons:

- After the change of control, the domestic insurer would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed;
- The effect of the merger or other acquisition of control would be substantially to lessen competition in insurance in the state or tend to create a monopoly;
- The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders;
- The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer or not in the public interest;
- The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control; or
- The acquisition is likely to be hazardous or prejudicial to the insurance-buying public.

As part of the evaluation of any application for a change in control, the supervisor requires applicants to meet financial and non-financial resource requirements, which are dependent on the business plan submitted and ultimately accepted by the supervisor.

An NBFC must provide prior notice to the FRB for approval before acquiring the shares of an entity which has total consolidated assets of US\$ 10 billion or more and is engaged in the activities described in section 4(k) of the BHC Act, which includes insurance and

	<p>providing investment advisory services.</p> <p><b>Foreign Ownership</b></p> <p>In cases where outside jurisdictions are involved, the domestic supervisor collaborates and coordinates, where relevant and necessary, with corresponding supervisors of those persons/entities.</p> <p><b>Demutualization and Conversion of Companies</b></p> <p>Under state laws that permit demutualization, a change of a mutual company to a stock company is subject to the supervisor's approval, and is subject to a comprehensive review of its proposed legal structure, including organizational documents and financial projections.</p> <p><b>Portfolio Transfer</b></p> <p>Portfolio transfers require consent of individual policyholders. In addition, the Model Holding Company Act and Regulation (#440 and #450) requires supervisory approval on the transfer of all or a part of an insurer's business. As part of the review process, the supervisor will ensure that the interests of the policyholders of both parties are not adversely impacted.</p>
Assessment	Observed
Comments	Although 2010 amendments to the Model Holding Company Act have not been adopted by all states, all requirements mentioned in ICP 6 have been adopted by all states and District of Columbia.
<b>ICP 7</b>	<p><b>Corporate Governance</b></p> <p>The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.</p>
Description	<p><b>Legal and Regulatory Framework</b></p> <p><u>States'</u> insurance-specific regulatory requirements in relation to governance are limited at present. Insurers are subject to a wide range of corporate governance requirements in state corporate law codes (differing by state) as well the specific requirements on publicly traded companies, where applicable. State laws include requirements on the general duties and responsibilities of boards.</p> <p>States have chosen to supplement these requirements with additional standards of their own, including requirements for audit committee duties and requirements for board oversight of investment and actuarial processes. However, their general approach is to focus on governance at the level of individual insurers via the supervision process, through offsite work (responding to major changes in corporate governance which have to be reported to states as they occur) and through the examination process.</p> <p>The objective is to make the approach to governance proportionate to the scale and complexity of individual insurers (all of which are subject to examination). The approach is also driven by an objective of avoiding potential conflict under different state laws between the duties of boards to shareholders and regulatory duties in relation to the</p>

<p>protection of policyholders.</p> <p>States can and do on occasion seek to enforce general corporate governance laws against particular insurance companies via the law officers of the state.</p> <p>There are a limited number of in-force NAIC model laws or regulations that address corporate governance. In addition to the examination process, supervisors assess governance mainly in the context of applications for licenses from new insurers and producers, in requiring and reviewing annual statements and in approving mergers or other changes of control involving domestic insurers, and in the assessment of solvency.</p> <p>There is a requirement for insurers that exceed an annual premium threshold of \$500 million that a board audit committee be formed, that external auditors report to that committee, that it oversees internal audit and that the membership has sufficient independence. (<i>Annual Financial Reporting Model Regulation (#205—also known as the Model Audit Rule), section 14</i>).</p> <p>In addition, there are some specific responsibilities placed on boards of directors:</p> <ul style="list-style-type: none"> <li>• to receive an annual report from the appointed actuary on the results of their loss reserve analysis as outlined in NAIC’s Annual Statement Instructions;</li> <li>• to adopt and approve changes to the investment policy utilized by the insurer and to oversee its ongoing investment activities (<i>NAIC Model #280 and/or #283</i>); and</li> <li>• to attest to the fact that it oversees the corporate governance and internal control functions of the insurance holding company group on an annual basis and that the insurer’s officers or senior management have approved, implemented, and continue to maintain and monitor corporate governance and internal control procedures (<i>NAIC Model #440</i>).</li> </ul> <p>All these provisions are generally required of all states.</p> <p>The NAIC’s Financial Condition Examiners Handbook, Financial Analysis Handbook and Company Licensing Best Practices Guide have been extensively updated since the 2010 FSAP to include additional guidance on assessing corporate governance practices.</p> <p>The states’ approach is developing. Significant extensions of states’ requirements in relation to governance and risk management will be introduced through:</p> <ul style="list-style-type: none"> <li>• new requirements (but for large companies only) on risk management and Own Risk and Solvency Assessment (ORSA—see also ICPs 8 and 16), which will include requirements on the Board’s role in overseeing risk strategy and risk appetite; first submissions are required in 2015 (<i>Risk Management and Own Risk and Solvency Assessment Model Act (RMORSA Model Act #505)</i>).</li> <li>• if adopted by the NAIC and implemented by the states, proposed new requirements on insurance companies to report to regulators on the details of their corporate governance (rather than changes in governance, as at present), starting potentially in 2016; these requirements would include provision of detailed information on Board oversight of risk management practices; and</li> <li>• the development of a common assessment methodology to support the evaluation of corporate governance practices by analysts and examiners.</li> </ul> <p>None of these initiatives, nor the existing Handbooks, will result in directly enforceable</p>
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requirements being placed on insurance companies. The onus will remain on the supervisory process to promote high standards of corporate governance in practice. The public availability of the NAIC Handbooks provides some guidance to firms on the state supervisors' expectations, although these are designed as guidance for the use of state supervisory staff, have no legal force, and focus mainly on the process of analysis or examination.

Specifically in situations where an insurer is deemed to be in a hazardous financial condition, the insurer can be ordered to correct deficiencies in corporate governance. This provision of the relevant model law will become an explicit requirement for accreditation in 2017. (*Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385)*).

The FRB has issued high level guidance on governance applicable to all large FRB-supervised institutions, including relevant SLHCs and NBFCs. SR12-17 (a supervisory notice rather than a rule) states that boards of directors should provide effective corporate governance with support of senior management, should establish and maintain the firm's culture, incentives, structure, and processes that promote its compliance with laws, regulations, and supervisory guidance.

It goes on to set high level expectations of groups in relation to corporate strategy and institutional risk appetite, oversight of senior management, corporate culture, adequacy of internal audit, corporate compliance, risk management and internal control functions, assignment of responsibility for investments and compensation arrangements and management information systems (MIS). There are no insurance-specific requirements in the SR. (*SR 12-17, December 17, 2012 paragraph 2: Corporate Governance*).

### **Supervisory practice**

Under the risk-focused surveillance framework, state supervisors assess corporate governance during both the financial analysis and examination processes (see also ICP9).

- The Financial Analysis Handbook requires analysts to assess governance, drawing on board and audit committee minutes, information on the structure, members and meeting frequencies of critical management and operating committees, Sarbanes-Oxley filings and similar filings through the NAIC Model Audit Rule, as applicable.
- The Financial Condition Examiners Handbook sets out expectations in relation to assessment of corporate governance in the planning and execution of a financial examination. Examiners must evaluate, for example, the quality of oversight by the Board and the effectiveness of management.

As part of the initial phases of the examination process (those related to understanding the company and assessing inherent risks) Board members and senior management are interviewed. Governance issues may be in greater depth in later phases of the examination process, depending on which risks are identified for evaluation.

Issues assessed by examiners in connection with the role of the Board include its degree of challenge to management and its role in establishing the appropriate "tone at the top". As mentioned in the assessment of ICP5, there are limited requirements on the suitability of directors and managers in the state regulatory system. Examiners may assess the knowledge, integrity and experience of directors and whether the board oversee management's role in developing, communicating and enforcing a code of conduct. Exhibit M in the Financial Condition Examiners Handbook sets out an extensive



	<p>set of questions for examiners.</p> <p>Examinations may also focus on the board’s oversight of the compensation of executive officers and head of internal audit, including the nature and appropriateness of incentive compensation plans—and whether they eliminate, reduce, or manage material adverse risks to the company that may arise from compensation practice. Insurers are required to disclose annual compensation information on the most highly compensated executives to regulators through the NAIC’s Supplemental Compensation Exhibit.</p> <p>Where an insurer is part of a holding company group, the work on corporate governance focuses on “the level at which insurance operations are directly overseen (e.g., ultimate parent company level, insurance holding company level, legal entity level).” (<i>Exhibit M in the Financial Condition Examiners Handbook</i>).</p> <p>If deficiencies in the corporate governance practices of a company are identified, the examiners make recommendations to the company in the examination report or management letter, and update the insurer summary profile and supervisory plan (see ICP9) accordingly. The department may adjust its ongoing solvency monitoring of the insurer to reflect the risks associated with governance shortcomings.</p> <p>Group level governance is a key focus of on-site supervisory work by the FRB. As described in the assessment of ICP9, supervisory teams review documentation, interview directors and management and sit in as observers at board and management meetings. FRB supervisors provide feedback observations and can and do require remedial action.</p>
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>Neither state nor FRB supervisors have set formal broad-based, insurance-specific governance requirements, at legal entity or at group/holding company level. Both state and FRB supervisors primarily rely on assessing the risks in individual companies and groups, through regular oversight and, at state level, through the examination process. The FRB is relying on guidance and a supervisory approach developed for banking groups.</p> <p>There is a highly structured approach for carrying out state evaluation work on governance in preparation for examinations and a thorough process for carrying out the examinations themselves, as evidenced in documentation reviewed by the assessors. Annual reporting by companies to the state regulators on governance arrangements, if introduced as proposed, will add further to the effectiveness of supervisory work.</p> <p>However, reliance on company reporting requirements, examinations work and general state corporate governance requirements should be supported by governance requirements appropriate for insurance business—and which engage the board of directors in particular in overseeing the management of insurance risks, recognizing the interests of policyholders alongside those of shareholders.</p> <p>The application by the FRB of an approach developed for large banks has intensified supervisory work on group-wide governance at FRB-supervised groups. Many management and governance issues are common to banks and insurance groups; and with only 17 groups to regulate, many of them large, the FRB can take a tailored firm-by-firm approach. However, the development of specific requirements for insurance groups is needed to help focus supervisory work on where insurers and banks are different, and on where the major risks in insurance groups arise.</p>

	<p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• States and the FRB develop appropriate standards for insurance company governance, to be applied at legal entity and/or group level and implement these through the model law process or FRB requirements.</li> </ul>
<b>ICP 8</b>	<p><b>Risk Management and Internal Controls</b></p> <p>The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.</p>
Description	<p>As in the case of corporate governance, the <u>states</u> lack a comprehensive framework of legally-enforceable requirements on risk management and internal controls specific to insurance companies. While companies are required to attest to the effectiveness of controls, the general approach of state regulators is to focus on controls at the level of individual insurers via the licensing and supervision processes, in both offsite work and examinations. As with governance, the objective is to make their requirements proportionate to the scale and complexity of individual insurers.</p> <p>In line with this approach, however, recent model law developments, to take effect in coming years, have introduced new requirements for larger companies (see below).</p> <p>All insurance companies have to be audited. Supervisors to an extent look to the external audit process to check the adequacy of controls and for material control weaknesses to be reported to them by auditors.</p> <p>In addition, all but the smallest insurers must have an independent audit committee. Since 2010, and those with US\$500 million or more in premium income are also required to issue the Management Report on Internal Control Over Financial Reporting, attesting to the adequacy of internal controls. The function of this requirement is similar to the attestations required of public companies subject to Sarbanes-Oxley reporting requirements. (<i>Annual Financial Reporting Model Regulation (Model #205) section 17</i>).</p> <p>At the group level, the Insurance Holding Company System Model Act requires the ultimate controlling person/entity to file an annual Enterprise Risk Report ("Form F") which identifies to the best of their knowledge and belief, the material risks within the insurance holding company system that could pose enterprise risk to the insurer. The Act defines enterprise risk as any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole, including, but not limited to, anything that would cause the insurer's RBC to fall into company action level.</p> <p><b>Control Functions</b></p> <p>Insurance companies are not currently subject to any in-force requirements by state regulators to have specified control functions.</p> <p>In respect to <u>risk management</u>, recent legislation has, however, introduced a requirement for a risk management framework to take effect in 2015. The NAIC Risk Management and Own Risk and Solvency Assessment Model Act (RMORSA Model Act #505) requires larger insurers (legal entities exceeding \$500 million or groups exceeding</p>

<p>\$1 billion in annual premiums) to maintain a framework to assist the insurer with identifying, assessing, monitoring, managing, and reporting on its material and relevant risks. (See also ICP16).</p> <p>20 states have adopted legislation in line with the model act so far and the key requirements take effect in 2015 (ORSA requirements are not an accreditation standard and could not become a standard until 2017 at the earliest under the NAIC accreditation process).</p> <p>A separate document entitled “NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual” contains more specific guidance on the elements of an effective ERM framework expected of insurers subject to the ORSA requirement, including:</p> <ul style="list-style-type: none"> <li>• governance structures that clearly define roles, responsibilities and accountabilities and a risk culture that supports accountability in risk-based decision making.</li> <li>• risk identification and prioritization processes with clear responsibilities and oversight by the risk management function.</li> <li>• a formal risk appetite statement and associated risk tolerances and limits.</li> <li>• the management of risk to be an ongoing ERM activity.</li> <li>• risk reporting and communication into risk management processes that achieves transparency and that is decision-useful.</li> </ul> <p>There is no requirement for insurers to have a <u>compliance function</u>. The Financial Condition Examiners Handbook does, however, provide guidance to examiners on assessing the compliance function.</p> <p>Companies are required to appoint a qualified <u>actuary</u> (the appointed actuary) to give an opinion on the reasonability or appropriateness of company reserves on an annual basis under the Standard Valuation Law (#820) and Actuarial Opinion and Memorandum Regulation (#822) for life insurers and through the NAIC’s Annual Statement Instructions for property/casualty and health insurers. There are no explicit requirements for insurance companies to have an actuarial function.</p> <p>Minimum qualifications for the appointed actuary are outlined within the regulation and instructions and supported by additional detail in U.S. actuarial professional standards.</p> <p>There are no requirements for an <u>internal audit function</u> at present, although larger firms will be required to establish one in the future. A 2014 revised version of the Annual Financial Reporting Model Regulation, when adopted by states, will require large insurers to maintain an internal audit function capable of providing independent, objective and reasonable assurance to the audit committee and management regarding the insurer’s governance, risk management, and internal controls. (<i>Annual Financial Reporting Model Regulation (Model #205) section 15</i>).</p> <p>Again, the Financial Condition Examiners Handbook outlines the appropriate role for an internal audit function and guidance on how to conduct a review.</p> <p><b>Outsourcing</b></p> <p>The states have some specific requirements of insurers in relation to outsourcing. The Model MGA Act (#225) governs contracts with non-affiliated managing general agents (MGAs) and is required for accreditation. The NAIC Custodial Model Acts (#295 &amp; 298) govern the outsourcing of investment custodial functions to non-affiliates (adopted by</p>
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	<p>over 30 states and included in Examiners Handbook) and more than 40 states have adopted some form of the NAIC’s Third Party Administrators Guideline (#1090). Further, in the case where the arrangement is with an affiliated company, there is a requirement under the Insurance Holding Company System Act and Regulation (#440 &amp; 450) for the transaction to be reported to the regulator.</p> <p>Again, material outsourced functions are subject to review during examination. The Financial Condition Examiners Handbook sets out extensive guidance to examiners covering the types of arrangement used by insurance companies such as managing general agents, producers and custodians as well as third-services such as payroll processing, claims review, claims processing, premium processing, investment management, reinsurance program management or general IT processes.</p> <p><b>FRB</b></p> <p>The FRB’s supervisory guidance on corporate governance at the largest FRB-supervised companies requires that boards ensure that the organization’s internal audit, corporate compliance, and risk management and internal control functions are effective and independent, with demonstrated influence over business-line decision making. (<i>SR 12-17, December 17, 2012 paragraph 2: Corporate Governance</i>).</p> <p>There is a requirement that the large groups maintain independent internal audit and other review functions with appropriate staff expertise, experience, and stature in the organization to monitor the adequacy of capital and liquidity risk measurement and management processes, (<i>SR 12-17, December 17, 2012 section A paragraph 1: Capital and Liquidity Planning and Positions</i>).</p> <p>SLHCs are subject to a wide range of risk management and other requirements in SR 11-11 and SR 14-9, derived from FRB banking regulation or the requirements of the SLHC regulator prior to 2011 and the Dodd-Frank Act. There are no insurance-specific requirements.</p> <p>Risk management and controls are a key focus of on-site supervisory work by the <u>FRB</u>. As described in the assessment of ICP9, supervisory teams review documentation, interview directors and management – and maintain a relationship with the heads of group-wide control functions (such as the CRO and Head of Internal Audit). FRB supervisors provide feedback observations and can and do require remedial action.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>Neither states nor the FRB have a comprehensive set of requirements on risk management and controls tailored to the business and risks of insurance companies.</p> <p>In the absence of requirements on firms to have control functions (and no ongoing suitability requirements applying to key control function office holders, where they are appointed by firms—ICP5), there is a risk that states’ expectations of high standards in these areas are not communicated to and understood by companies as clearly as necessary.</p> <p>The thoroughness of the examination process, and comprehensiveness of the published examiners guidance, does, however, mitigate the risks, as does the framework of requirements introduced for financial controls in recent years. The introduction shortly of a requirement for internal audit functions at larger firms will extend the framework further, in a proportionate way, as will the ORSA requirements in the area of risk</p>

	<p>management.</p> <p>With only 17 groups to regulate, most of them large, the FRB can and does take a tailored approach to risk management and controls, as to other issues. However, FRB guidance material and the supervisory approach needs further development to address the particular expectations of groups that are mostly engaged in insurance business.</p> <p>(This ICP is closely related to ICP 7 (Corporate Governance). Some issues of relevance to ICP 8 and material to its rating are reflected in the assessment and the rating of ICP 7).</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• after the introduction of the ORSA regime and requirement for an internal audit function, the states review the range of their standards on risk management and control functions, assessing whether standards embedded in the ORSA requirement should be applied to a wider population of firms and whether to require at least the larger firms to have risk management, compliance and actuarial functions; and</li> <li>• the FRB develop and communicate a set of expectations in relation to risk management and internal controls for insurance NBFCs and SLHCs.</li> </ul>
<p><b>ICP 9</b></p>	<p><b>Supervisory Review and Reporting</b></p> <p>The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.</p>
<p>Description</p>	<p><b>Regulatory authority, powers and resources</b></p> <p>States derive their authority to supervise from specific laws, particularly the NAIC Model Law on Examinations, which gives them wide authority to collect information as well as to conduct examinations, and the Insurance Holding Company System Regulatory Act and Regulation (in respect of information required of groups). The NAIC accreditation standards include the requirement that the state insurance departments should have the authority to examine companies whenever necessary, while the Model Holding Company Act and Regulation is also an accreditation standard.</p> <p><b>Supervisory approach</b></p> <p>The states' supervision operates under the NAIC's Risk-Focused Surveillance Framework, originally implemented in 2004, which encompasses off-site and on-site supervision within a single framework for assessing risk and taking supervisory action.</p> <p>The original objective of the approach was to enhance the qualitative aspects of examination and financial analysis and to introduce increased prospective risk assessment, i.e., identifying insurers at risk of solvency issues, which may be because of shortfalls in management. The approach was designed to be more risk-based than previously and to focus more on governance, risk management etc. The framework was also designed to support effective coordination between the organizationally separate financial examination and financial analysis functions within state insurance departments.</p> <p>The risk-focused approach has now been implemented by all states. It is described in</p>

detail in the Financial Analysis and Financial Condition Examiners Handbooks, which are also publicly available. More recently, there has been a focus on extending financial analysis to cover the financial condition of groups and making the examination process more efficient—for example, by scheduling more multistate examinations. The NAIC has also instituted an Examination Peer Review process under which states can submit examinations of particular companies for review and challenge by a group of peers.

The five elements of the Risk-Focused Surveillance Cycle are: (1) risk-focused examinations, using a seven phase examination process; (2) financial analysis based on filings and other information; (3) the review of key developments—such as changes in ratings, ownership or management, business strategy or plan; (4) a prioritization system for assigning firms to a category based on the risk assessment; and (5) the supervisory plan outlining the surveillance planned, the resources to be dedicated to supervision and planned communication and/or coordination with other states.

At the heart of the system is the Insurer Summary Profile, the document which records in one place (and for sharing with non-domestic supervisors) the main findings from the various lines of supervisory work as they occur.

The responsibility for managing the process (and for providing continuity of supervisory coverage) rests with the financial analysis teams. For the largest insurers, several staff are typically assigned to the team in the states with domestic companies (i.e., companies incorporated in that state). They also conduct regular discussions with the management of insurance companies, for example on the basis of the annual results.

The analysts also handle the significant volumes of transactions work that can be generated by state requirements, including the filings required under the Insurance Holding Company System Regulation. Large numbers of staff process rate and form filings in the market regulation functions.

The framework is kept under review by the NAIC Risk-Focused Surveillance (E) Working Group and changes are reflected in the regularly-updated Handbooks, including changes to reflect updates to the accreditation standards as well as input from the FAWG peer review process and Chief Financial Regulators Forum.

### **Regulatory reporting**

Each state publishes a list of required filings. There are deadlines for the key statutory annual and quarterly statement filings. The scope and content of the filings are set out in the “NAIC Blanks”—providing templates and instructions, including for confidential and proprietary information that is filed with the state and not received by the NAIC. Ad hoc requests for information are also made regularly by regulators for filing with the state. Separate confidential filings are made on RBC to the NAIC and the states.

Most supervisory reporting is focused on individual insurance companies and there is no reporting of group financial data (see ICP23).

For insurers considered potentially troubled, modifications to filing deadlines and frequencies are made, for example to require quarterly rather than annual RBC filings or monthly rather than quarterly statutory financial statements.

The accounting required to be used for all traditional insurers is the NAIC Accounting Practices and Procedures Manual (AP&P Manual), the codified body of accounting designed to meet regulatory needs. Individual state regulators may prescribe or permit alternative accounting practices, although such variances from the AP&P Manual must

be disclosed in the quarterly and annual statements.

Annual and quarterly statement filings are reviewed by NAIC staff for consistency and reasonability errors. Financial solvency reviews by NAIC and state analysts also highlight reporting errors, which are notified to the company and other regulators (if applicable). If the company does not respond to the NAIC with corrections, the regulator decides whether to require a correction or to allow the company to fix the issue in a future filing.

States require annual audits of domestic insurance companies by independent certified public accountants (this is also an accreditation standard).

States require submission of information on off-balance sheet exposures in the regular financial statements. However, they do not currently require material outsourced functions or significant changes in corporate governance to be reported (although some may fall within the reporting requirements for intra-group transactions). A new Corporate Governance Annual Disclosure Model Act and accompanying Regulation will greatly extend reporting to the states on governance issues, if adopted by the NAIC and when filings begin in 2016.

There is a continuous review of reporting requirements undertaken by NAIC committees.

#### **Off-site monitoring and review**

The risk-focused surveillance process starts with the analysis of the legal entity financial reporting, increasingly supplemented by confidential and proprietary data, holding company reporting and, for many states, market conduct data. The objective is to identify those legal entities with the most significant risks, initially for full off-site quarterly reviews as well as on-site reviews (examinations).

Much of the process at the NAIC in respect of quarterly and annual financial statements is automated, as is appropriate given the number of companies reporting. The fuller reviews of higher priority companies typically include the financial position and solvency assessment, quality of underwriting results and investment returns, risk management as well as compliance concerns with state and federal law.

As described in the introduction to this assessment, there is extensive support from NAIC staff and peer review processes (the FAWG) in assessing the financial condition of major companies and troubled companies. Company management may occasionally be asked to present to the FAWG.

The lead state for groups now also performs at least an annual financial analysis of the insurance group following procedures in the Financial Analysis Handbook, which focus on holding company filings and wider sources of information such as reviews of U.S. GAAP/SEC filings where relevant—a parallel review of the largest groups' U.S. GAAP reporting is undertaken by the NAIC.

#### **On-site visits and inspections**

Examinations must be undertaken by law at least once every three to five years depending on the state. The NAIC model law sets a maximum of five years and states are converging on this frequency, partly to facilitate multistate examinations.

Group-wide examination (focusing, for example, the governance and controls assessment on the group-wide approach where there are centralized functions) is increasingly the norm, even though (published) examinations reports continue to be produced for each legal entity. The Financial Condition Examiners Handbook outlines

seven major phases of the risk-focused approach:

- (1) understanding the company and identifying key functional activities to be reviewed;
- (2) identifying and assessing inherent risk in activities;
- (3) identifying and evaluating risk mitigation strategies/controls;
- (4) determining residual risk;
- (5) establishing/conducting examination procedures;
- (6) updating the prioritization and the supervisory plan; and
- (7) drafting the examination report and management letter based on findings.

It also contains substantial amounts of supporting guidance (e.g., sources of material to analyze before and during an on-site examination, content of and approach to examination reports and management letters to insurers) and technical material (e.g., on reinsurance) to assist examiners. Examinations have to be completed and the report finalized within 18 months of the period to which they relate.

As mentioned in ICP2, external specialists must be engaged (under the accreditation standards) and are used in practice to support examination work, where necessary. Some states outsource substantial amounts (and in some cases, all) of the examinations to consultant companies including the large international accounting and auditing practices.

Examination reports of insurers are available to the public and as a result convey only factual information. Examination work papers and management letters to insurers are generally not public, although they are available to other state supervisory authorities.

There are extensive supporting NAIC systems for planning, documenting, following up and reporting on individual examinations as well as on examination activity in aggregate.

#### **Conduct of business supervision (see more detail in ICP19)**

States are increasing their data collection from insurers on market conduct issues, including through the NAIC Market Conduct Annual Statement (MCAS). A Market Analysis Working Group (MAWG), a cross-state group of around 16 state regulators operates on similar principles to the FAWG. States have been increasing their market analysis capacity.

Market conduct examinations are conducted under the NAIC Market Conduct Examiners Handbook, where adopted by states (there are no accreditation standards in this area). Depending on the resources and structure of the insurance department, examinations may be undertaken jointly with a financial condition examination. The findings on market conduct are fed into the assessment of risks in an insurer by the financial analysts.

#### **FRB**

The FRB has authority under the Dodd-Frank Act and HOLA to undertake off-site monitoring and on-site examinations of NBFCs and SLHCs themselves and on their regulated and non-regulated subsidiaries. (*12 U.S.C. § 5361(b) and 12 U.S.C. § 1467a(b)(4)*).

The supervisory approach to SLHCs and NBFCs is developing and will be affected by the implementation of enhanced prudential standards, including group-wide capital requirements. For the NBFCs, the FRB is engaged in developing group-wide stress



	<p>testing and in annual reviews of recovery planning (and with the FDIC, resolution planning—on the basis of the groups’ “living wills”—see ICP26). Supervisory work is coordinated through the Operating Committee of the Large Institution Supervision Coordinating Committee (LISCC).</p> <p>The objective of the FRB’s supervisory process is to evaluate the overall safety and soundness of the SLHC and NBFC, taking a group-wide perspective. There is a strong focus on group governance, risk management and controls (i.e., evaluating central group functions) with reference to supervisory standards and expectations originally developed for large banking groups and now applied to SLHCs (SR 11-11 and SR 14-9) and NBFCs (mainly SR12-17 on governance).</p> <p>Regular reporting will be required by the FRB in the future. Supervisors rely currently on existing reporting to the state insurance supervisors and bank regulators where relevant, U.S. GAAP/SEC reporting, where available (not all SLHCs are subject to SEC requirements) and the collection of internal management information from the companies. The FRB is required to rely as far as possible on the information and assessments provided by other supervisors and regulators to support effective supervision.</p> <p>For the larger groups, including NBFCs, FRB supervisors engage in continuous monitoring, reviewing documentation, interviewing management, attending board and committee meetings etc. There is no regular full scope examination process. The FRB can and has intervened to require changes in practices, in areas such as documentation standards and model validation processes, distinguishing between matters requiring immediate attention (MRIAs), matters requiring attention (MRAs), and observations.</p> <p>Absent a group capital standard (see ICP17), the FRB’s oversight of groups’ financial condition is limited at present, although supervisors discuss group financial information and capital plans with management and take a view on overall financial soundness.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>State regulators have a highly developed approach to offsite analysis, drawing on comprehensive legal entity reporting and a powerful analytical capacity and peer review framework led by the NAIC. Their approach has been significantly strengthened by the further development of holding company system analysis and the enhanced role of the lead state regulator and will be further strengthened by new reporting on corporate governance, if agreed at the NAIC.</p> <p>Financial condition examinations have become more risk-focused, with more attention to qualitative issues and forward-looking judgments on “prospective risks”; and they are more often coordinated with other states and conducted as examinations of groups. Market regulation examinations appear to have further to go in this regard.</p> <p>Even for financial examinations, there appears to be scope for more confidential judgments to be included in management letters. Furthermore, the continued requirement for publication of a factual examination report on a legal entity basis absorbs significant resource and risks misleading readers where confidential supervisory issues are under discussion. The states are, however, considering modifications to the format to make it more representative of the work performed under a risk-focused examination.</p> <p>A five years maximum examination cycle is long by comparison with financial sector</p>

	<p>regulators in many other countries and other US regulators, especially in respect to larger or otherwise higher risk firms. It could be shortened or supplemented with targeted examinations for larger groups (not mainly where there are indicators of potential risk, as at present), accepting that this would require significant resource reallocation.</p> <p>The FRB’s approach draws heavily at present on tools and techniques developed for the major banking groups. As recognized by the FRB, there is a need to adapt and supplement these with supervisory tools that are tailored for insurance groups, to the extent (as is the case with many SLHCs and both NBFCs) that these are the most significant risks in the group, as well as maintaining a focus (in the case of NBFCs) on those aspects of the group’s business that may cause financial stability risks.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• The states review the adequacy of reporting on qualitative issues such as material outsourcing and adopt the proposed new framework for corporate governance reporting.</li> <li>• The states review the scope for a higher frequency of examinations or increased targeted examinations between the regular full scope exams, for the larger groups; and consult on whether they should remove the requirement for examination reports to be published.</li> <li>• The states review the scope for more coordinated multistate market conduct examinations.</li> <li>• The FRB develop and publish a tailored supervisory framework and appropriate tools addressing insurance risks for the supervision of the SLHC and NBFC insurance groups, including stress tests that include insurance risk scenarios such as a major pandemic.</li> </ul>
<p><b>ICP 10</b></p>	<p><b>Preventive and Corrective Measures</b></p> <p>The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p>
<p>Description</p>	<p>Only the states have powers to intervene directly and to require corrective actions in respect of individual insurance companies. (See below on FRB powers.)</p> <p><b>Operating without a license</b></p> <p>The states have broad powers (such as the issuance of a cease and desist notice) to take enforcement action against individuals or entities that operate without a license. In cases where there is the potential for immediate harm to policyholders, supervisors can take immediate steps to issue and enforce a cease and desist action in coordination with law enforcement agencies.</p> <p><b>Power to take Corrective and Preventive Measures</b></p> <p>The state supervisors have broad powers (imposing fines, the suspension or revocation of licenses, imprisonment and also disallowance of dividend payments, requirements to submit action plans etc), depending on the degree and natures of violation of acts and</p>

	<p>regulations.</p> <p>In particular, NAIC Model Law # 385 (Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition) lays down standards or criteria that the supervisory authority can use to determine if an insurer is in a hazardous financial condition. These are all subject to criteria or trigger points such as reserve adequacy, reinsurance adequacy and collectability, fitness and propriety of officers and directors, timely and accurate return filing, adequacy of administrative systems, liquidity and appropriateness of affiliate transactions. Compliance with the model law is evaluated in the accreditation process.</p> <p>The model law also outlines the actions the supervisory authority can require an insurer to take to remedy its financial condition, which may include adjusting reinsurance, reducing or suspending acceptance and renewal of business, increasing capital and surplus, suspending dividend payments, increasing the frequency of financial reports, providing additional detailed reports, providing a new business plan, adjusting premium rates, changing investments and correcting corporate governance practice deficiencies.</p> <p><b>Progressive Escalation</b></p> <p>The Risk-Based Capital (RBC) Model Act (# 312) provides the following four levels of supervisory intervention with each level becoming progressively more challenging and demanding on the insurer.</p> <p><u>Company Action Level</u></p> <ul style="list-style-type: none"> <li>• Trigger event—insurer capital less than 200 percent of RBC, or less than 300 percent of RBC and also has a negative trend (for life and health) or triggers a trend test (P&amp;C).</li> <li>• Action required—the insurer must submit an RBC Plan within 45 days which identifies: causes of reaching the trigger event; corrective action proposals; financial projections for at least 4 years out (both without and with the corrective action); key assumptions; and the problems associated with the insurer's business.</li> </ul> <p><u>Regulatory Action Level</u></p> <ul style="list-style-type: none"> <li>• Trigger event—insurer capital less than 150 percent of the RBC amount.</li> <li>• Action required—insurer must prepare and submit an RBC Plan or revised RBC Plan; state supervisor must examine the insurer's financial condition and review its RBC Plan; state supervisor must issue a "corrective order" specifying the corrective actions the insurer must take.</li> </ul> <p><u>Authorized Control Level</u></p> <ul style="list-style-type: none"> <li>• Trigger event—insurer capital less than 100 percent of the RBC amount.</li> <li>• Action required—as for Regulatory Action Level, or place the insurer under regulatory control (i.e., under formal rehabilitation or liquidation) if this is considered to be in the best interests of the policyholders, creditors and the public.</li> </ul> <p><u>Mandated Control Level</u></p> <ul style="list-style-type: none"> <li>• Trigger event—insurer capital less than 70 percent of the RBC amount.</li> <li>• Action required—supervisory authority must place the insurer under regulatory</li> </ul>
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	<p>control (i.e., under formal rehabilitation or liquidation), except for property and casualty insurers in run-off where the supervisory authority may allow the run-off to continue under its supervision.</p> <p>The state supervisors have broad discretion in determining an acceptable plan and in establishing acceptable time frames when requiring action by firms. In the case of capital deficiencies associated with the RBC requirements, state laws provide fixed time frames for submitting an acceptable company action plan and the supervisory review of the company action plan. Supervisors use a variety of approaches to check on compliance including on-site inspections to verify that company actions have taken place.</p> <p>The assessors were apprised of a particular case involving a multistate insurer where the states intervened in response to potential financial strain at the firm by requiring it to cease new business and monitoring expenses pending negotiations for the company to be acquired. Preparations were made for receivership at the same time. State supervisors also intervened (including using rehabilitation procedures—ICP11) in the case of financial guaranty insurers that were subject to severe stress in the financial crisis.</p> <p><b>FRB</b></p> <p>The FRB, as the consolidated supervisor of SLHCs may take a number of actions or remedial measures regarding the capital and operations of the consolidated organization but may not take direct action regarding approved insurance activities of those institutions. Such actions include restricting the current activities and operations of the organization, requiring new remedial activities, withholding or conditioning approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases.</p> <p>Similarly, the FRB may take a number of actions against a NBFC, including issuing cease and desist orders and removing certain individuals from office in the company. (<i>12 U.S.C. § 5362</i>).</p>
Assessment	Observed
Comments	<p>States have a full range of powers to intervene, require remediation and to escalate their response as necessary and they use these powers in practice. They are supplemented by specific actions that the FRB may take in respect of holding companies subject to their regulation.</p> <p>In respect to financial condition, the system of RBC-related company and regulatory action levels and the associated triggers and required actions provide for automatic intervention ahead of stress, but their extensive financial reporting and financial analysis tools, including RBC forward simulations, also equip supervisors to intervene on a discretionary basis and start discussions with senior management at an early stage.</p>
<b>ICP 11</b>	<p><b>Enforcement</b></p> <p>The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.</p>
Description	As for preventive and corrective measures (ICP10), only the states have powers to intervene directly and to require corrective actions in respect of individual insurance

companies. (See below on FRB powers).

### **Legal authority**

State regulators have broad discretion and wide range of powers to apply appropriate enforcement where problems are encountered. These powers include the following:

- restrictions on business activities
- requirements to increase loss reserves
- requirements to increase capital
- submitting and implementing RBC corrective actions
- restricting dividend and other payments out of the insurer
- directing to stop issuing new policies
- measures to retain expert help in addressing complex areas
- requiring changes in management
- fining individual directors and senior managers of insurers
- suspending or revoking the license.

State supervisors also have effective means to address management and governance problems. Under the Hazardous Financial Condition Model Regulation (#385), the supervisor has the authority to correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the supervisor.

Under the same model regulation, the supervisor can consider whether the management of an insurer, including officers, directors, or any other person who directly or indirectly controls the operation of the insurer, fails to possess and demonstrate the competence, fitness and reputation deemed necessary to service the insurer in such position.

### **Conservatorship**

Subject to a court of competent jurisdiction, the supervisor may be appointed as conservator of an insurance company if the insurer is failing to meet prudential or other requirements. The supervisor has broad discretion to retain experts and other individuals in the court oversight of insurance companies in conservatorship.

### **Sanctions**

The Model Holding Company Act empowers state regulators to levy financial penalties and/or to bring criminal proceedings (which may result in fines or imprisonment) against directors or employees of an insurance holding company system who willfully and knowingly subscribe to or makes or causes to be made any false statements or false reports or false filings with the intent to deceive the commissioner in the performance of his or her duties under the Act. In 2013, about US\$19 million has been collected with fines and other monetary penalties, which accounted for 1.5 percent of the total funding of state regulators.

### **Practices**

The states impose civil penalties and other measures in responses to breaches of its requirements by insurance companies. The state regulators have taken a number of regulatory actions taken against insurers. For example, in 2013, 179 suspensions, 127

	revocations and 798 formal hearings have been undertaken by state regulators.
Assessment	Observed
Comments	States have wide range of enforcement measures and use those actively and effectively.
<b>ICP 12</b>	<p><b>Winding-up and Exit from the Market</b></p> <p>The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with the insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to provision of benefits to policyholders.</p>
Description	<p><b>Winding up and Exit of an Insurer</b></p> <p>The states' receivership laws include authority for the conservator or rehabilitator to possess all the powers of directors, officers and managers of an insurer, whose authority may be suspended, and such authority may include the power to discharge employees.</p> <p>In practice, state regulators seek to use their authority to put an insurer under administrative supervision, rehabilitation or even liquidation to effect compulsory transfer of obligations from a failing insurer to another insurer. This is often done by keeping a failing/failed insurer in run-off and under administrative supervision and arranging a reinsurance transaction with the accepting insurer, or improving the financial condition of the problem insurer sufficiently for the accepting insurer legally to take ownership.</p> <p><b>Policyholder Priority</b></p> <p>The legal framework gives priority to the protection of policyholders and subordinates the claims of general creditors to those of policyholders. Insurance Receivership Model Act (# 555) stipulates the highest priority after the administrative fees of the receiver are met. Although the Act has not adopted by all states, states generally have adopted similar clauses so that policyholders are given the highest priority in windings-ups after the administrative fees of the receiver are met.</p> <p><b>Coordination with Other States</b></p> <p>The NAIC's Financial Analysis Working Group (FAWG), which is comprised of solvency experts, performs an analysis of financially troubled insurers and their groups, separate from that of the domiciliary state. They also provide support for the state regulators and for coordination of multi-state actions to address solvency problems. The effect, in the case of such companies, is to increase information-sharing amongst the state regulators involved and also to deliver support and challenge.</p> <p><b>Guaranty Funds</b></p> <p>Guaranty associations work in tandem with the insolvency laws and are established to provide a safety net for policyholders and other claimants and beneficiaries of the insurance coverage.</p> <p>Guaranty fund protection is triggered by the legal finding of insolvency and serves to indemnify policyholders who have suffered a claim, up to stated limits (48 states adopted 250,000 or more for life and health products which is provided by Life and Health</p>

	<p>Insurance Guaranty Association Model Act, however for other products and other states have range of limits between US\$100,000 to 500,000. For P&amp;C side, guaranty fund provide up to 300,000).</p> <p>Policyholders’ benefits would be covered 100 percent up to the limits and historically at least 96 percent has been covered either by guaranty associations or remaining assets of failed insurers. Although the funds of the guaranty associations are accumulated on an ex-post basis, approximately US\$ 10 billion can be collected annually. Given that average loss rates of historical failures have been about 25 percent of the insurance liability, it may be able to absorb failures up to total asset of US\$ 40 billion per year, which is about the same size as the 25<sup>th</sup> largest life insurance company (general account).</p> <p><b>Resolution of insurers and holding companies under the Dodd-Frank Act</b></p> <p>Under Title II of the Dodd-Frank Act, where an insurer or holding company for which the largest subsidiary is an insurer, the Secretary of Treasury (in consultation with the President) may make a systemic risk determination, pursuant to statutorily prescribed criteria, to place such a company into receivership. This determination would initiated by a recommendation from the Director of FIO and the FRB (in consultation with the FDIC).</p> <p>Title II can only be applied to insurers that are found to present systemic risk. The process has not been used to date.</p> <p>In making a systemic risk recommendation, the FIO and FRB (in consultation with the FDIC) must evaluate various statutorily prescribed criteria, including whether the company under consideration is in default or danger of default. The Secretary of the Treasury (in consultation with the President) must also make a determination based on statutorily prescribed criteria, including that the financial company is in default or in danger of default.</p> <p>Title II provides that the liquidation or rehabilitation of an insurance company in these circumstances shall be conducted under applicable state law (although this limitation does not apply to a holding company of an insurance company that is not itself an insurance company). If the appropriate state regulator does not act within 60 days to begin orderly liquidation proceedings for the insurer, the FDIC has the authority to “stand in the place of the appropriate regulatory agency and file the appropriate judicial action in the appropriate State court to place such company into orderly liquidation under the laws and requirements of the State.” (12 U.S.C. § 5383(e)(3)).</p>
<p>Assessment</p>	<p>Observed</p>
<p>Comments</p>	<p>States have appropriate tools to wind-up insurance legal entities effectively while protecting policyholders’ benefits as far as possible. In practice, the level of insolvencies has been low, even during the financial crisis, although a significant number of companies (136 as of the end 2013) have entered into run-off.</p> <p>The relatively prescribed system of indicators of financial strain and procedures for dealing with troubled companies (including the FAWG process) has meant that interventions have been taken at an early stage.</p> <p>Dodd-Frank has introduced a new process, involving federal authorities, in cases where systemic risk is an issue but even where the new process is used (it has not been yet), state insolvency law (as tried and tested of a number of years) would continue to be</p>

	<p>used.</p> <p>While it is not required under ICP 12, it is not yet clear whether current resolution regime is effective enough for a large (and particularly a large and internationally active) insurance group (such as designated NBFCs). It is recommended that the states work closely with federal and International regulators, and resolution authorities to improve resolvability of large and complex insurance groups.</p> <p>While there is some overlap in coverage between the ICPs and the FSB’s Key Attributes of Effective Resolution, the substantive requirements of the two standards are not equivalent with regard to recovery and resolution issues. Accordingly, the conclusions on these issues set out in this assessment may differ from those reached in the Key Attributes technical note.</p>
<p><b>ICP 13</b></p>	<p><b>Reinsurance and Other Forms of Risk Transfer</b></p> <p>The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.</p>
<p>Description</p>	<p>Prudential regulation for reinsurers domiciled and licensed in the United States are similar or identical to that for insurers. Market regulation is adapted, given that reinsurance transactions are expected to be between knowledgeable parties.</p> <p>Statutory credit is given for business ceded to a reinsurer only if the reinsurer meets certain requirements. Non-US licensed reinsurers have to set up reinsurance collateral. The NAIC adopted revisions to the Credit for Reinsurance Model Law (MDL 785) and Credit for Reinsurance Model Regulation (MDL 786) which reduce their collateral requirements for reinsurance that are licensed and domiciled in qualified jurisdictions. Currently, Bermuda, Germany, Switzerland and the United Kingdom are qualified jurisdictions. The ‘Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions’ documents the process for the determination of qualified jurisdictions. Requirements for eligibility for reducing the collateral include financial strength, timely claims payment history and that the reinsurer is domiciled and licensed in a qualified jurisdiction. (<i>NAIC Credit for Reinsurance Model Law, # 785; NAIC Credit for Reinsurance Regulation, # 786</i>).</p> <p>The Dodd Frank Wall Street Reform and Consumer Protection Act includes section 531(a) of Title V that specifies that if the home state of the ceding insurer recognizes credit for reinsurance for the insurer’s ceded risk, no other state can deny such credit for reinsurance. States cannot compel companies incorporated in other states to abide by its rules. (<i>The Dodd Frank Wall Street Reform and Consumer Protection Act, Title V, section 531(a)</i>).</p> <p>Apart from collateral requirements, the focus of regulation and supervision of reinsurance lies on the ceding companies.</p> <p>A number of laws, regulations and guidelines relate to the regulation of credit for reinsurance transactions:</p> <ul style="list-style-type: none"> <li>• NAIC Credit for Reinsurance Model Law and Regulation, No 785 and No 786.</li> <li>• NAIC Life and Health Reinsurance Agreements Model Regulation, No 791.</li> </ul>



	<ul style="list-style-type: none"> <li>• NAIC Insurance Holding Company System Regulatory Act and Regulation, No 440 and 450.</li> <li>• Statement of Statutory Accounting Principles (SSAP), No 61 and 62R.</li> <li>• Appendix A-785 Credit for Reinsurance, Appendix A-791 Life and Health Reinsurance Agreements.</li> </ul> <p>Model Laws 785 and 786 provide the legal framework under which US domiciled insurers are allowed credit for reinsurance. SSAP 61 and 62R provide statutory accounting guidance for reinsurance transactions for life and health and P&amp;C insurers.</p> <p>SSAP requires that reinsurance have to transfer risk, otherwise the insurer has to follow the guidance for deposit accounting. SSAP 61 specifies these requirements for life and health insurers, SSAP 62R for P&amp;C insurers.</p> <p>Model laws 440 and 450 relate to regulation of reinsurance transactions between affiliated companies. They set disclosure and reporting requirements for intra-group reinsurance transactions. Reinsurance agreements above a certain limit have to be reported 30 days prior to their implementation. The Commissioner can disapprove of these transactions within that period.</p> <p>Cedants are required to have reinsurance and risk transfer strategies, systems, processes and controls in place. Cedants' reinsurance programs and policies are assessed first at the point of licensing of an insurer. The application must include the summary of the reinsurance program and all reinsurance agreements together with a short summary. The analysis and assessment of reinsurance is part of the monitoring of licensed insurers. The NAIC Financial Analysis Handbook describes the focus of the ongoing supervision and the expectations on insurers also with respect to reinsurance. During the quarterly and annual reviews of insurers' statements, the assessment of reinsurance is a key part, which includes the review of insurers' reinsurance programs, of accounting for reinsurance, of significant recoverables, the purpose of reinsurance with a view on possible fronting or pyramiding, etc.</p> <p>Examiners are tasked to analyze how risks are mitigated through reinsurance, focusing on the amount of catastrophe reinsurance, reinstatements, the actual risk transfer, the quality of the reinsurers, etc.</p> <p>The Financial Condition Examiners Handbook gives detailed guidance on the assessment of reinsurance programs. There are clear expectations on a reinsurance strategy, the interconnection between the reinsurance program and the insurer's limit system, reinsurance policies, and the need for evaluation of the reinsurance program and contracts. Further requirements relate to governance for claims handling, the administration of reinsurance programs and record keeping.</p> <p>Insurers have to disclose information on reinsurance programs and have extensive reporting requirements to state regulators. Insurers have to file annual and quarterly financial reports that also allow regulators to analyze the reinsurance programs. Examiners analyze material reinsurance contracts during inspections, with a more in-depth assessment of reinsurance programs, their governance and risk management being undertaken by examiners.</p> <p>Documentation requirements on reinsurance contracts are appropriate to the nature of reinsurance. For life and health insurers, reinsurance agreements can only be taken into account once an agreement, amendment or a binding letter of intent has been duly</p>
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	<p>executed. For P&amp;C companies, regulation recognizes that often reinsurance agreements are only finalized until after the beginning of the policy.</p> <p>State regulation takes into account potential liquidity risk associated with reinsurance agreements. The handbooks on examination clearly state expectations on the liquidity risk management of cedants as well giving guidance for examiners on how to assess potential liquidity risks. Supervisors analyze reinsurance contracts and discuss liquidity issues with cedants.</p> <p>State regulation takes into consideration structures where risks are transferred to capital markets. Supervisors are aware of issues related to these structures and analyze them accordingly.</p>
Assessment	Observed
Comments	<p>The regulation of reinsurance is comprehensive and supervision practices appropriate, with due consideration of risks. The NAIC handbooks give detailed guidance on best practices and on the evaluation of reinsurance programs.</p> <p>State regulators analyze material intra-group reinsurance contracts. However, if an insurance group or holding company has a complex web of retrocessions in place, there can be interactions which impact the potential performance of retrocessions. It is recommended that state regulators also undertake a comprehensive review of the web of retrocessions, taking into account potential capital mobility, the credit risk of affiliated entities and other issues. This would extend the focus of state regulators on the group or holding company as a whole while retaining and strengthening their focus on legal entities.</p> <p>It is recommended that the FRB analyze the interaction of the web of retrocessions in particular for systemically important insurance groups. For these insurance groups, the analysis of the web of retrocessions is essential to understand the situation of the group in financial stress. While this is expected to be done within the scope of resolution planning, the analysis should also focus on situations outside the narrow scope of resolution planning. A methodology and a conceptual framework should be put in place to analyze the web of retrocessions and collect the necessary information from the regulated entities.</p> <p>It is recommended that</p> <ul style="list-style-type: none"> <li>state regulators analyze the interaction of the web of retrocessions and the group's or holding company's structure in more depth;</li> <li>the FRB analyze the interaction of the web of retrocessions in particular for systemically important insurance groups.</li> </ul>
<b>ICP 14</b>	<p><b>Valuation</b></p> <p>The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.</p>
Description	<p>The valuation of assets and liabilities is defined in the Statutory Accounting Principles (SAP) which are codified in the NAIC Accounting Practices and Procedures Manual (APPM). The APPM consists mainly of Statements of Statutory Accounting Principles</p>

<p>(SSAP), which are accounting practices and procedures promulgated by the NAIC. The valuation standard for assets and liabilities is highly detailed and continuously updated and adapted. SAP is based on US GAAP, but adapted for the purpose of insurance regulators with a view to conservatism and the protection of policyholders.</p> <p>The valuation standard is based predominately on an amortized cost approach or fair value with impairment assessment. For P&amp;C liabilities, the valuation standard is highly principles-based and mainly based on US GAAP. It is the responsibility of the appointed actuary to determine P&amp;C reserves, which are determined on an undiscounted basis except for certain lines of long-term business e.g. workers' compensation. For life insurance liabilities, the valuation standard in contrast is predominately rules-based, with detailed rules and regulations on the valuation of specific products. Assets are valued according to amortized cost or fair value in accordance with the nature of the investments.</p> <p>In general, the valuation of liabilities is based on conservative principles. P&amp;C reserves are not discounted with certain exceptions, while life insurance reserves are based on conservative assumptions on certain parameters. While the principles are conservative, it is not necessarily the case that the resulting reserves are also conservative.</p> <p>Discounting for life insurance policies is based either on prescribed discount rates or on the expected return of assets associated with the insurance liabilities.</p> <p>The prudential valuation standard is highly dependent on actuaries. All supervised insurers have to have an appointed actuary who is appropriately qualified - defined by NAICs 'Actuarial Opinion and Memorandum Regulation' for life and health insurance as a member in good standing of the AAA, who is qualified to sign statements of actuarial opinion for life and health company annual statements in accordance with AAA qualification standards, is familiar with the relevant valuation requirements and satisfies an number of fit and proper requirements. For P&amp;C insurers, the qualifications are similar requiring the actuary to be a member in good standing of the Casualty Actuarial Society, or to be a member in good standing of the AAA who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the AAA. (<i>NAIC Actuarial Opinion and Memorandum Regulation</i>).</p> <p>For many NAIC model laws and regulation, the Actuarial Standards Board of the American Academy of Actuaries formulates detailed guidance. Actuarial Standards of Practice of the AAA are binding for appointed actuaries while Practice Notes are educational. In many cases the AAA supports the NAIC in developing valuation standards or adaptations and improvements of the RBC framework.</p> <p>Life insurers have to submit a Statement of Actuarial Opinion (SAO) which sets forth the opinion of the appointed actuary related to reserving based on the Asset Adequacy Analysis. In addition, the appointed actuary has to submit a memorandum describing the analysis being done in support of the opinion on the reserves. The memorandum has to be made available for examination to the regulators on request. There is detailed guidance by the NAIC on the scope and content of the SAO and the memorandum in the Actuarial Opinion and Memorandum Regulation.</p> <p>In respect to the Asset Adequacy Analysis, the Actuarial Opinion and Memorandum Regulation specifically refer to the Standards of Practice of the Actuarial Standards Board that have to be followed.</p> <p>State supervisors base their assessment on the sufficiency of reserves on an analysis of</p>
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the SAO and other documentation that is supplied by the insurers.

The valuation of life insurance liabilities is highly detailed and rules-based. The Standard Valuation Law, # 820 and the Valuation Manual that was adopted by the NAIC in 2012 give detailed guidance on the valuation of life, accident and health and deposit type contracts. For many products, assumptions on times of sale are required to be used, e.g. mortality and interest rate assumptions at the time the contract have been sold. Life insurance products are often complex, including options and guarantees, e.g. variable annuities. For these products the rules-based approach has been extended and more principles-based reserving approaches are required to be used. (*NAIC Standard Valuation Law, # 820, Valuation Manual*).

### **Asset Adequacy Analysis**

Life insurers have to perform an Asset Adequacy Analysis. Assets are set up against liabilities which are then tested under a number of economic scenarios. The insurer has to test whether assets are sufficient to cover liabilities over the lifetime of the insurance contracts. A number of scenarios must be used that are then applied to a cash flow model. Requirements are set out in the Actuarial Opinion and Memorandum Regulation.

The state regulator in New York has defined seven scenarios (the “New York Seven”) which are a de facto standard in many states and used by many actuaries. Assets do not have to be sufficient to cover liabilities for all scenarios, but in general the reserve adequacy requirement is set in the range of 67% to 83%. There is a wide variety of approaches used by actuaries. For interest rate scenarios, actuaries use deterministic and stochastic approaches, where for the stochastic approaches real-world or risk-neutral scenarios or a combination thereof are applied. (See Asset Adequacy Analysis, August 2014 Exposure Draft by the American Academy of Actuaries).

The asset adequacy analysis is a sense check for the prescribed formulaic determination of reserves. Reserves have to be strengthened if the asset adequacy analysis shows that assets are not sufficient to cover liabilities. While this introduces a level of prudence, by taking the maximum of two reserves that are based on different methodologies, there is no consistent underlying concept for the valuation standard anymore. Asset adequacy analysis is required in a number of regulations, including NAIC AOMR, The Valuation of Life Insurance Policies regulation, New York Regulation 127, Actuarial Guideline 34 (Variable Annuity Minimum Death Benefit Reserves) and Actuarial Guideline 39 (Reserves for Variable Annuities with Guaranteed Living Benefits).

### **Principles-Based Reserving**

The NAIC has developed an approach for principles-based reserving (PBR) for life insurance products. This approach reduces the complexity of the formula-based static approach to calculate reserves for products and, if adopted by the states, would made the valuation standard more consistent. PBR is based on the Standard Valuation Law (SVL) which was adopted by the NAIC in 2009. The associated Valuation Manual was adopted by a super-majority of NAIC members in 2012. However, only once at least 42 states (a supermajority) representing 75 percent of total U.S. premium adopt the revisions to the SVL, will PBR be implemented. This target has yet to be reached.

Valuation standards can differ from state to state and for insurers and captives. State regulators can introduce permitted practices which lead to different reserving requirements for identical businesses.

	<p><b>Conservatism and Margins</b></p> <p>Neither Life nor P&amp;C reserves consist of a current estimate and an explicit Margin over Current Estimate. Conservatism is included in life insurance reserves by using prudent parameters, while P&amp;C reserves are in general undiscounted. Margins are implicit and there is no distinction in general between the (discounted) current estimate and an explicit margin over the current estimate.</p> <p>Levels of conservatism are different for different products and lines of business. The use of parameters set at the times of sale, historical interest rates and non-discounting of P&amp;C reserves all lead to varying levels of conservatism, or lack thereof.</p> <p>The valuation of technical provisions does not necessarily allow for the time value of money. P&amp;C reserves are not discounted. Life insurance reserves, depending on the product are often discounted using parameters or contractual provisions set at the time of sale. In other cases, life insurance policies are discounted with reference to interest rates defined in the past, while in still other cases the discount rate is set with reference to the expected return on assets held.</p> <p><b>The Federal Reserve Board</b></p> <p>The FRB has not yet decided on which valuation standard it intends to base its capital standard for insurance groups that it regulates.</p>
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>The current valuation standard for life insurers is prescriptive and in many cases formula-based. As insurance products have become more complex, the prescribed algorithms and formulae used to determine reserves have grown in complexity accordingly. New products often require tailor-made approaches for valuation, resulting in a variety of formulae and approaches and a large amount of guidance, rules and regulation necessary to cover the valuation of specific products.</p> <p>Assumptions used for reserving are often static and set at the time the insurance products were sold. The valuation standard has varying levels of conservatism, which leads to a lack of transparency.</p> <p>The valuation standard uses amortized cost for specific assets under a hold-to-maturity argument for assets that cover liabilities. This argument breaks down for products where appropriate risk management requires a frequent re-balancing of the asset portfolio.</p> <p>The valuation standard does not necessarily give appropriate incentives for dynamic hedging for products where this would constitute appropriate risk management.</p> <p>The shortcomings of the valuation standard are circumvented and mitigated by complex structures that life insurers engage in. In some states, affiliated captives can hold fewer assets to back reserves. At the captive level, the full formulaic reserve is required, however, for captives the difference between the full formulaic reserve and the economic reserve is allowed to be backed by other assets. These other assets could include letters of credit, which do not meet the definition of an asset in GAAP or statutory accounting.</p> <p>It would be more logical to change the valuation standard to reflect the economics of the products better. PBR would reduce incentives for the captive structures but its date of implementation is uncertain. PBR would reduce many of the shortcomings outlined above. It would be better placed to deal with complex products—both current and</p>

	<p>future ones—and would reduce the tendency to engage in regulatory arbitrage, i.e. via affiliated captive transactions. It would reduce the need for vast armies of actuaries, accountants and other specialists to be working solely to apply Band-Aids to a valuation standard that is not able to cope with complex products with embedded options and guarantees. The supervisory review of PBR will require sufficient expertise of the state regulators.</p> <p>Allowing for conservatism explicitly in a margin over current estimate would increase transparency. The explicit decomposition of reserves into a current estimate and a margin over current estimate allows the assessment of the overall conservatism for different lines of products. This would allow a recalibration of the valuation standard for products where reserves are overly conservative or not sufficient. Such a recalibration would counteract the tendency to engage in regulatory arbitrage</p> <p>Any capital requirement that the FRB has to develop has to be based on a valuation standard. Required capital is defined by applying a risk measure to the (random) change in value of assets and liabilities over the given time horizon. The FRB should consider the development or use of a valuation standard that is useful to capture the risks to which SLHC and NBFCs groups are exposed.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• the NAIC continues to pursue the update of the valuation methodology for life insurers based on principles based reserving;</li> <li>• captives and insurers have to use the same valuation requirements;</li> <li>• the valuation standard is applied consistently across all states;</li> <li>• the valuation standard is consistently defined taking into account how assets that cover liabilities are actually managed;</li> <li>• the valuation standard is adapted such that it captures conservatism explicitly in a margin over current estimate;</li> <li>• state regulators ensure that they have sufficient expertise in-house to cope with principles-based approaches to reserving; and</li> <li>• the FRB defines a valuation standard for their regulated insurance entities.</li> </ul>
<p><b>ICP 15</b></p>	<p><b>Investment</b></p> <p>The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.</p>
<p>Description</p>	<p>Investment limits are defined in the Investments of Insurers Model Act (MDL #280). It clearly defines different types of investment as well as investments that are prohibited to invest in for life and health, property and casualty, financial guaranty and mortgage insurers. It spells out clear limits for different asset classes and monitoring and reporting requirements. (<i>Investments of Insurers Model Act, # 280</i>).</p> <p>The model act sets clear limits on medium and lower grade investments and Canadian investments; on rated credit instruments; on insurer investment pools; on equity interests; on tangible personal property under lease; on mortgage loans and real estate; on securities lending, repurchase, reverse repurchase and dollar roll transaction; on foreign investments and foreign currency exposure; and on derivative transactions. The</p>

	<p>above investment classes are further subdivided and additional limits imposed, e.g. construction loans, on single counterparties etc.</p> <p>Further limitations are imposed in the Investments in Medium and Lower Grade Obligations Model Act (MDL #340). Limits are again imposed on an aggregate level as well as on exposures to single counterparties and different rating classes.</p> <p>The Model Act also describes the authority of the insurance commissioner in case an insurer is not in compliance with the investment law.</p> <p>If the insurer is deemed to be in hazardous financial condition, the requirements of the 'Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition' (MDL #385) come in force. It allows the commissioner to require from the insurer to limit or withdraw from certain investments or discontinue certain investment practices. (<i>Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition', # 385</i>).</p> <p>There is detailed guidance on how to assess investment portfolios for supervisors in the Financial Analysis Handbook and the Financial Condition Examiners Handbook. The Financial Condition Examiners Handbook gives detailed guidance on how to assess the governance and risk management related to investment. It details the practices that insurers are expected to follow as well as tests of controls that supervisors can execute. Expected practices range from governance structures that challenge, approve and review market forces that may cause strain on the investment portfolio, the requirement for an investment strategy; the use of stress testing; process in place to ensure that investments comply with guidelines; the assessment of credit risk based not solely on credit rating agencies; the need for diversification to protect against the impact of climate change; and much more. There are clear expectations formulated that insurers understand and manage properly the assets into which they invest.</p> <p>The handbooks further express the expectation that insurer have investment policies that satisfy a number of requirements, e.g. on the involvement and responsibility of the board of directors in investment, the consideration of risk, the quality and maturity and diversification of investments.</p> <p>There are detailed and comprehensive requirements in the relevant model acts and the handbooks for more complex and less transparent classes of assets. Reporting and disclosure requirements are extensive.</p> <p>The relevant model acts and the handbooks address security, liquidity and diversification both quantitatively and qualitatively.</p> <p>A strong focus is put on liquidity risk. The Financial Condition Examiners Handbook sets the expectation that insurers have a formal written liquidity plan. Detailed liquidity tables help examiners to analyze the liquidity position of insurers. The handbook contains guidance on how to assess risk related to liquidity and on how to evaluate liquidity risk management controls.</p> <p>The NAIC scoring system is based on ratios and allows supervisors to focus on insurers with higher risk. A component of the ratios is related to liquidity risk. Some states further test liquidity using stress tests. For example New York conducts a 'Liquidity and Severe Mortality Inquiry'. It collects both qualitative and quantitative information on the current liquidity position as well as the liquidity position under financial stress.</p>
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	<p>Further implicit limits on investments are imposed by capital charges in the RBC framework where higher risk charges for riskier investments give incentives to limit exposures to risky assets.</p> <p>Some states have adapted some of the limits and imposed specific limits for insurers domiciled within their jurisdiction. But overall the limit framework has been adopted by all states.</p> <p>Affiliated captives are allowed in some states to cover liabilities with assets that are not consistent with investment rules for direct insurers. In some states, affiliated captives can cover liabilities with parental guarantees or letter of credits.</p>
Assessment	Observed
Comments	<p>The investment limits defined in the model acts, together with the detailed (and public) expressed expectation in the Financial Analysis Handbook and the Financial Condition Examiners Handbook constitute a sophisticated framework to limit investment risk. There is strong focus on liquidity risk and the security, liquidity and diversification of investments.</p> <p>Regulators have strengthened their requirements on securities lending. There is a strong focus on the liquidity position and overall limits on securities lending have been imposed.</p> <p>The current low-interest rate environment has already given rise to an increased hunt for yield, albeit from a low level. If the low-interest rate environment continues, this tendency will likely grow, with increased investments in illiquid and more risky investments. If some insurers increase their investments into more exotic asset classes, the NAIC might also consider adapting their definition of investments to ensure that insurers properly assign their investments to the appropriate asset classes. Although regulatory arbitrage transactions between insurers in different states have not been observed, there is a risk of such arbitrage as investment limits of various states are not consistent at legal entity level and there is no group wide investment requirement.</p> <p>Identical investment rules and limits should be imposed on affiliated captives to which insurance liabilities are ceded. Aligning requirements of affiliated captives with those for insurers, together with a change in the valuation standard, would reduce regulatory arbitrage and increase overall transparency.</p> <p>(The group aspect of this ICP is reflected in the assessment and the rating of ICP 23).</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• identical investment rules and limits are imposed on affiliated captives to which insurance liabilities are ceded to; and</li> <li>• state regulators in cooperation with the NAIC, FRB and FIO continue to analyze investment activities both at legal entity level and group level and address any regulatory arbitrage by improving consistency of investment requirements across state and federal regulations.</li> </ul>



<p><b>ICP 16</b></p>	<p><b>Enterprise Risk Management for Solvency Purposes</b></p> <p>The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.</p>
<p>Description</p>	<p>State regulation sets requirements and expectations on Enterprise Risk Management as well as the approach to assess these in different laws: The Insurance Holding Company System Model Regulation Act (MDL #450), the Risk Management and Own Risk and Solvency Assessment Model Act (MDL #505) and the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual, the Financial Analysis Handbook and the Financial Condition Examiners Handbook. The ORSA requirements will be in force as of 2015.</p> <p><b>Enterprise Risk Report</b></p> <p>MDL #450 requires that the ultimate controlling person files an enterprise risk report on Form F, which requires information at a holding company level on:</p> <ul style="list-style-type: none"> <li>• Material developments regarding strategy, internal audit findings, compliance or risk management.</li> <li>• Acquisition or disposals of insurance entities and other changes of the holding structure.</li> <li>• Material changes of shareholders of the insurance holding company system.</li> <li>• Significant investigations, regulatory activities or litigations.</li> <li>• Business plan and strategies.</li> <li>• Capital resources and distribution patterns.</li> <li>• Rating movements.</li> <li>• The web of corporate and parental guarantees.</li> <li>• Material activities or development that in the opinion of senior management could lead to adverse effects.</li> </ul> <p><b>The ORSA</b></p> <p>MDL #505 provides the requirements for the risk management framework and for the ORSA and provides guidance and instructions for filing an ORSA Summary Report. ORSA is defined as confidential internal assessment, appropriate to the nature, scale and complexity of an insurer or insurance group, conducted by that insurer or insurance group of the material and relevant risks associated with the insurer or insurance group's current business plan, and the sufficiency of capital resources to support those risks. An insurer has to maintain a risk management framework to assist with the identification, assessment, monitoring, managing and reporting of material and relevant risks.</p> <p>On request, an ORSA Summary Report has to be submitted to the commissioner. If the insurer is part of an insurance group, the ORSA Summary Report has to be submitted to the commissioner of the group's lead state. The ORSA Summary Report has to be signed by the Chief Risk Officer or another executive with responsibility for oversight over the enterprise risk management process and also a copy has to be provided to the board of directors. Insurers with annual direct written and unaffiliated assumed premiums with less of US\$500 Million are exempt from ORSA requirements.</p> <p>The ORSA manual provides guidance on the scope and content of the ORSA Summary</p>

<p>Report. The ORSA has to be conducted at least annually to assess the adequacy of the risk management framework and current and estimated projected future solvency position, to document the process and results for internal purposes.</p> <p>The two primary goals of the ORA are to foster effective ERM and to provide a group-level perspective on risk and capital to supplement the existing legal entity view.</p> <p>The aim of state regulators is to achieve a high level understanding of the insurer's ORSA through the Summary Report. It will help to determine the scope, depth and timing of risk-focused analysis and examination procedures. For this the ORSA Summary Report should contain three sections:</p> <ul style="list-style-type: none"> <li>• Section 1: Description of the risk management framework.</li> <li>• Section 2: Assessment of risk exposures.</li> <li>• Section 3: Group assessment of risk capital and prospective solvency assessment.</li> </ul> <p>Insurers are also expected to document for internal purposes the ORSA results.</p> <p>The ORSA manual states expectations on insurer's ERM which should include as a minimum:</p> <ul style="list-style-type: none"> <li>• governance structures that clearly define roles, responsibilities and accountabilities and a risk culture that supports accountability in risk-based decision making;</li> <li>• risk identification and prioritization processes with clear responsibilities and oversight by the risk management function;</li> <li>• formal risk appetite statement and associated risk tolerances and limits;</li> <li>• the management of risk as an ongoing ERM activity; and</li> <li>• risk reporting and communication into risk management processes that achieves transparency and that is decision-useful.</li> </ul> <p>The ORSA Summary Report should describe the identification, categorization and management of relevant and material risk. It should also describe how the ERM identifies and deals with changes in risks.</p> <p>Section 2 of the ORSA Summary Report should provide a high-level summary of quantitative and qualitative assessments of risk exposures in normal and stressed situations for each material risk category. The assessment should consider the impact of stresses on capital, with consideration of risk capital requirements based on regulatory, economic, rating agency and other views. The ORSA Summary Report should provide a general description of the insurer's process for model validation.</p> <p>Section 3 of the ORSA Summary Report should describe the level of financial resources needed to manage the insurer's current business over a longer term business cycle. The group risk capital assessment can be done on different bases, e.g. group, legal entity or other but has to encompass the entire group. The group risk capital assessment should consider the elimination of IGTs and double gearing, leverage resulting from holding company debt; diversification and availability and transferability of capital; contagion, concentration and complexity risk; and the effects of liquidity risk.</p> <p>The insurer is expected to have a robust capital forecasting capability and be capital resources sufficient to operate in normal and in stress situations. If a group performs the prospective solvency assessment for each individual insurer, that assessment should may</p>
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	<p>take into account group risks, capital transfers between legal entities and limitation on capital mobility.</p> <p>The Financial Analysis Handbook and the Financial Condition Examiners Handbook contain many elements relevant to ICP 16. It sets clear expectations on risk management, the risk culture, asset liability and liquidity risk management, investments, reinsurance and other risk mitigation approaches, and process and controls.</p> <p><b>Requirements by the Federal Reserve Board</b></p> <p>The FRB’s approach to supervision focuses on institutions’ management of risk and expects comprehensive risk management policies and processes for the identification, evaluation, monitoring and controlling of risks to be in place. Expectations are formulated in the ‘Consolidated Supervision Framework for Large Financial Institutions’. It expects from large financial institutions for example that they:</p> <ul style="list-style-type: none"> <li>• put robust internal processes in place that enable the firm to maintain capital and liquidity under normal and stressful conditions;</li> <li>• maintain processes that enable the identification and measurement of potential risks to asset quality, earnings, cash flows, and other primary determinants of capital and liquidity positions;</li> <li>• conduct rigorous and regular stress testing;</li> <li>• maintain sound risk measurement and modeling capabilities;</li> <li>• establish goals for capital and liquidity positions that are approved by the firm’s board of directors taking into account legal or regulatory restrictions on the transfer of capital or liquidity between legal entities;</li> <li>• maintain a clearly articulated corporate strategy and institutional risk appetite; and</li> <li>• ensure the organization’s internal audit, corporate compliance, and risk management and internal control functions are effective and independent.</li> </ul> <p>The Dodd-Frank Act states that one of the purposes of the FSOC is to make recommendations to the FRB Board of Governors concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for nonbank financial companies and large, interconnected bank holding companies supervised by the Board of Governors.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>The ORSA requirements of the State Regulators are not yet in force but will become effective as early as 2015 for those states that have adopted it. At the time of the assessment, 20 states had adopted the Risk Management and Own Risk and Solvency Assessment Model Act.</p> <p>A number of requirements of ICP 16 are not strictly satisfied, e.g. requirements for insurers to have a risk management policy which includes explicit policies in relation to underwriting risk. While not formally satisfied, nevertheless the majority of requirements will be satisfied in spirit once ORSA will be in force.</p> <p>The state regulators have a supervisory approach which for qualitative requirements</p>

	<p>relies less on explicit and detailed rules, but on high-level principles and expectations that are formulated in the handbooks for examiners and analysts. ORSA will be mandatory for larger companies that cover over 90 percent of the market by premium income.</p> <p>The NAIC is implementing a training program for examiners and analysts. This will help that the risk-based approach to supervision which also relies on discussions with insurers on the appropriateness of their ORSA can be implemented consistently.</p> <p>The FRB will need to increase its expertise in insurance for the supervision of relevant SLHCs and NBFCs and make rules and regulation more specific to insurers. ERM and ORSA require expertise on risk to which insurers are exposed, not only from the supervised, but also from the supervisors. Insurers are not necessarily exposed to similar risks as banks, nor do they react to adverse events identically to banks. Rules and regulations should reflect these differences. The regulation and supervision of large and complex systemically important insurers relies in particular on this expertise.</p> <p>(The group aspect of this ICP is reflected in the assessment and the rating of ICP 23).</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• the FRB enhances their expertise in insurance risk and business models;</li> <li>• the FRB adapts its rules and regulation and approaches to take into account the specifics of insurers, where warranted; and</li> <li>• the state regulators and the NAIC consider requiring the ORSA for all insurers, proportionate to the size and complexity of the firms.</li> </ul>
<p><b>ICP 17</b></p>	<p><b>Capital Adequacy</b></p> <p>The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.</p>
<p>Description</p>	<p>Regulatory capital is determined by the Risk Based Capital (RBC) approach, which has been in place in the US since the early 1990s and is defined in the Risk-Based Capital (RBC) for Insurers Model Act. It is applied on a legal entity basis for life, P&amp;C and health insurers. It is based on the calculation of capital charges for specific risks, which are then aggregated using a correlation approach. The RBC focuses on three main risks: asset risk, underwriting risk and other risks. The RBC framework is continuously being updated and adapted by different working groups of the NAIC. The actual calculation of the RBC is set forth in RBC instructions for P&amp;C, Life and Health insurers which are updated regularly.</p> <p>Under the RBC system, supervisors have the authority and the mandate to take preventive and corrective measures, depending on the results of the RBC calculation and it allows supervisors to intervene if RBC indicates a hazardous condition of an insurer.</p> <p>There are no group-level capital requirements in place, for insurance groups including insurance NBFC groups as designated by the FSOC (except certain SLHCs with immaterial insurance activities). Some insurers are not subject to RBC, for example title insurers, monoline financial guaranty insurers and monoline mortgage guaranty insurers.</p> <p>The RBC framework does not allow for the use of internal models. RBC is largely based on factors that allow the calculation of the capital requirement without models.</p>

<p>Exceptions are mainly for the RBC for life insurers, in particular the RBC C3 Phase 1 and 2 calculations, which rely on insurers' cash flow models for valuation.</p> <p>Available capital resources are defined using SAP and take into account the quality and suitability to absorb losses on a going-concern and wind-up basis. SAP includes concepts such as conservatism, consistency and recognition to establish principles for assessing quality and suitability of capital resources.</p> <p>The NAIC has linked its development and maintenance process for SAP to GAAP. The NAIC's Statutory Accounting Principles Working Group deliberates on each new GAAP item and decides whether to adopt, reject, or modify it for SAP. It is responsible for developing and adopting substantive and non-substantive revisions to the Statements of Statutory Accounting Principles (SSAPs). The NAIC allows goodwill to be counted as an available capital resource, but only if it is arising from the purchase of an insurance subsidiary and it has to be written off over 10 years and cannot exceed 10 percent of an insurer's capital.</p> <p>The regulatory capital requirements have four control levels, which trigger different supervisory actions. The basis is the Authorized Control Level which is a solvency ratio of 100 percent, i.e. the available capital equals required capital based on the RBC calculation. The Regulatory Action Level is 1.5 times the Authorized Control Level, the Company Action Level is twice the Authorized Control Level and the Mandatory Action Level is 70 percent of the Authorized Control Level (for detail, refer to ICP 10).</p> <p>There are clear rules and regulations in place (Risk-Based Capital (RBC) for Insurers Model Act) that determine the actions being taken by supervisors if any of the control levels is breached. These actions range from the insurer being put under regulatory control either for rehabilitation or for liquidation, if the Mandatory Control Level is breached, to corrective actions if the authorized control level is breached; and increased supervisory scrutiny and a RBC plan to restore the solvency position if the Regulatory Control Level is breached.</p> <p>The RBC framework considers all material risk classes. There are a large number of papers and reports explaining the detailed workings of the RBC calculation and calibration. In broad terms, capital charges are calculated for major risk classes based on different holding periods of assets and liabilities and different confidence levels. These different capital charges are then aggregated using a correlation approach.</p> <p>Common risks for life, P&amp;C and health insurers are asset risk for affiliates, asset risk other (including credit risk, interest rate risk, and market risk); underwriting or insurance risk and business risk.</p> <p>For P&amp;C companies, RBC has eight major risk categories: R0 for off-balance sheet risks and risks arising from insurance subsidiaries; R1 for invested asset risk for fixed-income investments; R2 for equity and real estate risk; R3 corresponds to default risk; R4 for reserve risk and R5 for premium risk; R6 for earthquake catastrophe risk and R7 for hurricane catastrophe risk.</p> <p>These risk charges are then combined by: <math>R0 + (R1^2 + R2^2 + R3^2 + R4^2 + R5^2 + R6^2 + R7^2)^{1/2}</math></p> <p>For life insurance companies, there are 5 major risk categories: C0 for asset risk with affiliates; C1 for asset risk split into common stock and other risk, C2 for insurance risk, C3a for interest rate risk, C3b for health credit risk and C3c for market risk; and C4a for business risk and C4b for administrative expense risk. The capital charges are then</p>
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aggregated by :  $C0 + [(C1o + C3a)^2 + (C1cs)^2 + (C2)^2 + (C3b)^2 + (C4b)^2]^{1/2} + C4a$ .

For health insurers, there are 5 major risk categories: H0 for asset risks with affiliates,, H1 other asset risks, H2 for underwriting risk, H3 for credit risk and H4 for business risk; which are then combined by:  $H0 + [(H1)^2 + (H2)^2 + (H3)^2 + (H4)^2]^{1/2}$

While the aggregation formulae look simple, this is deceptive. The framework is complex and prescriptive, with a detailed guidance and rules for the calculation of each risk class. For example, the guidance for determining RBC for life insurers (RBC Forecasting and Instructions-Life) is approximately 170 pages of detailed instructions, while those for P&C insurers and health insurers are comparably extensive.

Operational risk is not explicitly quantified, but taken into account in the calibration of factors of business risk and qualitatively within the NAIC's ORSA framework. The Capital Adequacy Task Force of the NAIC has set up an Operational Risk Subgroup that has to evaluate options for developing an operational risk charge in each of the RBC formulas.

The Risk-Based Capital Standard is supplemented by a number of other approaches to assess risks to which insurers are exposed. State supervisors in addition have a number of other tools to assess the capital position of insurers. The NAIC has developed a forecast tool which allows state regulators to assess the RBC position of insurers on a quarterly basis. Since 1972, state insurance regulators have been using the IRIS system to evaluate the financial conditions of insurers. Different ratios are calculated which then lead to an overall assessment of the financial condition of insurers. Further tools are the Financial Analysis Solvency Tools (FAST); the Analysis Team System (ATS) which is an automated review process to prioritize the focus of supervision using statistical analysis, a scoring system and RBC numbers; the RBC trend test and loss reserve tools.

The RBC formula for life insurers writing products with embedded options and guarantees is complex and requires the use of valuation models.

RBC C3 Phase 1 was implemented in 2000 and addressed interest rate risk for annuities and single premium life products. It is calibrated to a 95 percent Value at Risk. A set of 200 economic scenarios are randomly generated and a subset of 12 or 50 is then used. The scenarios are applied to cash flow models and intermediate C3 values calculated. The final C3 requirement is then the weighted average of a subset of the ranked scenario specific C3 values. It is currently being updated to take into account the changed financial market environment.

RBC C3 Phase 2 applies to variable annuities and life contracts with GMDBs and addresses both equity and interest rate risk and has been in force since 2005. It is based on a Tail Value at Risk on a 90% confidence level. It requires the use of stochastic scenarios that are used in a cash flow testing model. It is the risk-counterpart for the valuation of the products considered by AG 43.

RBC C3 Phase 3 is not yet in force and would apply to all individual life policies and covers interest rate and market risk. It requires scenario testing which involves running a cash flow testing model over a number of scenarios based on a Tail Value at Risk of 90 percent.

While the NAIC defines the scenarios used by insurers and supplies scenario generators for both C3 Phase 2 and 3, the evaluation of these scenarios is based on cash flow models used by insurers.

The RBC does not take into account Intra-Group Transactions (IGTs), except for

retrocessions. The credit risk of business ceded is taken into account within the risk charges (e.g. by a 10% surcharge on the ceded portion of the modeled earthquake and hurricane risks) and also in C1, R3 and R4. The RBC calculation does not take into account parental guarantees and other forms of IGTs.

The RBC framework is continuously being updated and adapted. The NAIC has several working groups being tasked with updating the RBC framework: The Capital Adequacy Task Force, the Life Risk-Based Capital Working Group, the Property and Casualty Risk-Based Capital Working Group, the Health Risk-Based Capital Working Group and the Investment Risk-Based Capital Working Group and the Operational Risk Subgroup. The mandate of the Capital Adequacy Task Force is to evaluate and recommend appropriate refinements to capital requirements for all types of insurers and the above-mentioned working groups and subgroups refer to the Capital Adequacy Task Force. The development of changes is done in a transparent and open manner. The working groups and subgroups often develop their proposals together with actuarial task forces and proposals are open to public comment.

The RBC framework is consistent with the valuation standard, within the limits of this being possible with the amortized cost approach. The capital charges for specific risks are based on a holding-period of assets or liabilities. For example, the R1 capital charge for fixed-income investments addresses mainly default risk. For class 1 and 2 bonds, the holding period was assumed to be 10 years, while for class 3+ bonds, the risk factor was judgmental with no clear holding period. In addition, the Capital Adequacy Task Force is evaluating RBC in light of principle-based reserving (PBR) and is considering changes to RBC that will be needed because of the changes in reserve values, an expected increase in reserve volatility, and the overall desired level of solvency measurement.

The RBC is not calibrated to a target level. Capital charges for specific risks differ, depending on assumption on the holding-period and different confidence levels are assumed. For catastrophe risk, the holding-period or time-horizon is 1 year and a confidence level of 99 percent is used. The risk charge for reserve and premium risk in R4 and R5 has been calibrated to an 87.5% VaR over the claim run-off period (reserve risk) and 87.5 percent for one year of new business (premium risk).

Given that the RBC formula is calibrated to the (largely) amortized cost approach on which the valuation standard is based, it is not reasonable to expect a consistent target level. The overall target level will depend on the mix of investments and products in the portfolio of each insurer.

There is no capital standard on group level, neither for insurance groups including FSOC-designated NBFCs and insurance SLHCs by the FRB, or for insurance groups supervised by state regulators. State regulators have a strong legal entity focus and aim to protect policyholders by having capital requirements applied to each legal entity on a stand-alone basis. They have, however, not yet defined or implemented a group-level capital standard.

The new ORSA regulation that is in force as of 1 January 2015, if adopted by a state, would impose enterprise-wide risk management on insurance groups and holding companies that own insurers. As part of the ORSA regulation, insurers have to describe how they combine qualitative elements of their risk management policy with quantitative measures of risk exposure in determining the level of financial resources needed to manage their current business over a longer term business cycle (e.g. over the next one to three years). This requirement does not, however, mandate a capital calculation for

	<p>the group as a whole.</p> <p>The FRB has not yet defined a group level capital for insurance groups it regulates. The Dodd-Frank Act stipulates that the FRB has to establish minimum leverage and minimum risk-based capital requirements on a consolidated basis for a depository institution holding companies and NBFC companies supervised by the Board of Governors of the Federal Reserve System. The Dodd-Frank Act requires that the minimum risk-based and leverage requirements for these firms be no less than the generally applicable risk-based capital and leverage requirements that apply to insured depository institutions. However, a change to the statute enacted in late 2014 provides the FRB with more flexibility as it considers the appropriate group capital requirements for relevant groups.</p> <p>The FRB has started a quantitative impact study (QIS) to evaluate the potential effects of its revised regulatory capital framework on SLHCs and NBFCs supervised by the Board that are substantially engaged in insurance underwriting activity (insurance holding companies). However, the QIS gives no indication of a potential group-level capital standard or even the methodology (e.g. valuation basis, time horizon for capital, risks to be covered etc.).</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>The RBC framework used by state regulators is a sophisticated, risk-based capital framework that is improved continuously. Since it has been in force since the early 1990s, it has become complex as regulators have introduced changes and improvements. The basis of the US solvency framework is an amortized cost valuation standard that is rules-based. This results in the RBC formulae becoming increasingly complicated as insurance products—in particular life insurance products—become more complex and with that the underlying rules and regulations for their valuation.</p> <p>It would also be appropriate for the RBC framework were to be documented in a consistent set of documents, including its methodology, parameterization and assumptions and implementation.</p> <p>Financial guaranty insurers and mortgage insurers are not subject to the RBC, although the NAIC is currently developing a capital model for mortgage insurers. While financial guaranty insurers are still required to hold minimum capital and surplus requirements established on a state level, these have been shown to be not sufficient by a large margin during the financial crisis. In addition, it is not advisable for regulators to rely on external ratings, which performed badly in the run-up to the financial crisis.</p> <p>The strong focus of state regulators on the soundness of legal entities supports the protection of policyholders of legal entities. For legal entities of groups or conglomerates, the focus on legal entities alone is not necessarily enough. The NAIC has put in place qualitative requirements (mainly the Insurance Holding Company System Regulatory Act and the Own Risk and Solvency Assessment Model Act (in force as of 1 January 2015)). Quantitative group level capital requirements would enhance these qualitative requirements and help to increase transparency on the risks within a group and also reduce the risk of regulatory arbitrage.</p> <p>The FRB should develop and formulate its preferred approach to, for example, the underlying valuation standard to be used, the time horizon for capital, the risk measure of capital, and the legal entity or legal entities within the groups to which the capital requirement would be imposed. A common project of the FRB and the NAIC would</p>



	<p>facilitate the development of a capital standard that is as far as possible consistent with capital requirements on a state level (see also ICP 23).</p> <p>(The group aspect of this ICP is reflected in the assessment and the rating of ICP 23).</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• state regulators and the NAIC develop an RBC requirement for financial guaranty insurers and mortgage insurers, taking into account their specific exposures to risk;</li> <li>• state regulators and the NAIC develop an approach that would allow RBC to capture IGTs;</li> <li>• the FRB develops a capital standard for NBFCs and SLHC, with due consideration of accounting and actuarial standards, developing its methodology in cooperation with state regulators and the NAIC; and</li> <li>• state regulators, the NAIC and the FRB coordinate for common or consistent capital requirements to avoid regulatory arbitrages between the two capital requirements.</li> </ul>
<p><b>ICP 18</b></p>	<p><b>Intermediaries</b></p> <p>The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.</p>
<p>Description</p>	<p>Intermediaries are generally referred to as producers in the U.S. While distribution channels vary, producers may act as agents of one or more insurance company (captive agents or independent producers) or as brokers—i.e., acting on behalf of the customer. Banks also distribute insurance products. There are over 2 million licensed individual producers. States are involved in licensing, regulating and supervising producers. For variable insurance products, which involve a securities component, FINRA also is engaged in licensing and supervision.</p> <p><b>Legal authority and licensing</b></p> <p>The NAIC’s Producer Licensing Model Act (#218) requires states to license producers, and sets out licensing standards. This law has been implemented in a majority of the states but with slight variations. Producers are required to obtain licenses in every state where they operate. Only 30 percent operate in multiple states in practice.</p> <p>All individuals who sell, solicit or negotiate insurance are required by law to be licensed for each line of business (there are six categories). Both the individual and the business entity through which the producer operates must be licensed.</p> <p>Producers are required to renew their licenses on a regular basis—every two or three years depending on the state law.</p> <p>Applicants are asked about prior misdemeanor convictions, felony convictions and involvement in administrative proceedings. Individuals who have been convicted of a crime involving “dishonesty or breach of trust” are prohibited from engaging in the business of insurance unless they request and obtain a waiver.</p> <p>In addition, 27 states fingerprint their applicants to identify any prior criminal activity. Applicants must pass a test for each insurance line of authority they wish to sell, solicit or negotiate and complete a total of 24 hours of continuing education every two years,</p>

including three hours of education addressing ethics.

Under the model law, state insurance regulators have various powers to address misconduct by intermediaries (section 12 lists types of misconduct). These include suspension or revocation of both a resident and non-resident license as well as the levying of fines. In addition, a Federal law, 18 U.S.C. 1033, imposes a lifetime ban from the business of insurance for criminals whose crime involves dishonesty or breach of trust.

Because of the lack of uniformity in producer licensing requirements (and lack of reciprocal recognition between states' approaches) a national system for producer licensing has, for a number of years, been contemplated by the U.S. Congress—the National Association of Registered Agents and Brokers (NARAB). (Legislation enacted in early 2015 will now lead to the creation of NARAB.) In the effort to promote licensing reciprocity, the NAIC has established a process of certification of state producer licensing regimes that meet the licensing reciprocity mandates of the federal Gramm-Leach-Bliley Act, and 42 jurisdictions have been assessed as meeting the requirements.

### **Conduct and compensation**

Insurance producers who work as agents for one or more companies must, in 42 states (the model law provision is optional), obtain formal appointments with the companies they represent. Insurance companies are then required to notify relevant states of each appointment.

Producers are required to provide appropriate disclosure on the products they sell and their potential impact on the consumer if purchased and to assess the needs of their clients and suitability of particular products.

Under the Unfair Trade Practices Act model law (#880), producers must not misrepresent the benefits and conditions of a policy.

The Producer Licensing Model Act also provides that where an insurance producer receives compensation from the customer for the placement of insurance or represents the customer with respect to that placement, the producer shall not accept any compensation from the relevant insurer unless the producer has obtained the customer's prior documented acknowledgment of such compensation and has disclosed its amount. (There are otherwise no requirements to disclose amounts of commission.) (*Producer Licensing Model Act, section 18*).

Producers are not required in all states to make disclosures to customers of the status under which they are doing business, for example whether they are independent and which insurance companies have appointed them.

In 2011, New York revised its compensation disclosure requirements following settlement agreements in 2006 with Attorneys-General and regulators in a number of states with four major groups of mainly commercial lines brokers over commission-related issues, including the use of contingent commission.

Disclosure requirements have been strengthened. New York law now requires that insurance producers subject to the law disclose to purchasers, orally or in prominent writing at or prior to the time of application for the insurance contract:

- a description of the role of the insurance producer in the sale;
- whether the insurance producer will receive compensation from the selling insurer

	<p>or other third party based on the insurance contract the producer sells;</p> <ul style="list-style-type: none"> <li>• that the compensation paid to the insurance producer may vary depending on a number of factors, including (if applicable) the volume of business the producer provides to the insurer or the profitability of the insurance contracts that the producer provides to the insurer; and</li> <li>• that the purchaser may obtain information about the compensation expected to be received by the producer.</li> </ul> <p><i>(New York State Insurance Department, Regulation No. 194, (11 NYCRR 30): Producer Compensation Transparency).</i></p> <p><b>Client money/premium trust funds</b></p> <p>A license may be suspended or revoked when a producer has misappropriated a client’s money. However, states do not generally require an intermediary to have a separate account for the deposit of clients’ funds; and there is no NAIC model law provision in this area. State laws generally provide that funds received by any person acting as an insurance agent are received and held in a fiduciary capacity and shall be promptly accounted for and paid to the insurer.</p> <p>Some states have adopted their own provisions requiring brokers to establish separate accounts (premium trust fund accounts) to be used to hold money that has not yet been paid to insurers or which is to be remitted to clients. In many states, agents and brokers have a legal responsibility in relation to such funds in a fiduciary capacity—and may be required not to mingle their own and client funds.</p> <p><b>Ongoing supervision</b></p> <p>Producers are not subject to financial requirements or reporting to the regulator—although some states impose surety bond requirements on individual producers.</p> <p>Departments analyze and respond to consumer (and insurer) complaints about particular agents.</p> <p>Examinations of producers are not mandated as they are for insurance companies under the Model Law on Examinations; and departments have discretion whether and how often to carry them out (there is no NAIC examination manual for producers).</p> <p>Examinations of insurers may extend to producers acting as agents for the insurer, in particular where:</p> <ul style="list-style-type: none"> <li>• the insurer has appointed one or more managing general agent (MGA)—i.e., agents, usually focused on commercial risks, which may have authority from the insurance companies who have appointed them to accept business on their behalf and may also handle claims or help place reinsurance; and</li> <li>• the producer is a large broker focusing on commercial lines.</li> </ul>
Assessment	Largely Observed
Comments	While producer regulation is less uniform than that it is for insurance companies, in respect of both requirements in law and the supervisory work of departments, all states have requirements in relation to some of the key expectations of ICP18—such as licensing, requirements in relation to producer skills and expertise, and powers to

	<p>undertake examinations and to take action in case of producer misconduct.</p> <p>The general legal framework provides safeguards for client money where intermediaries act as agents (and this has been tested in numerous cases). Premiums must generally be held in a fiduciary capacity and be accounted for by all agents and brokers.</p> <p>Requirements in relation to contingent commissions (such as are paid by insurers to major commercial lines brokers based on business volume) have been strengthened through a disclosure approach and as a result of New York action. Requirements are not the same in other states.</p> <p>All insurance producers, including the major brokers with large global presences, are subject to supervision and must comply with state laws. While these institutions should clearly not be regulated or supervised in the same way as major insurance companies, closer oversight would be appropriate to reflect their impact on policyholders and market integrity.</p> <p>Some strengthening of the approach to producer regulation is recommended:</p> <ul style="list-style-type: none"> <li>• to develop a uniform approach to the regulation of larger business entities, including major commercial lines brokers; and</li> <li>• to require producers in all states to make disclosures to customers of the status under which they are doing business, including which insurance companies have appointed them.</li> </ul>
<b>ICP 19</b>	<p><b>Conduct of Business</b></p> <p>The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p>States are responsible for most market conduct regulation and supervision—although to the extent that some products are covered by securities legislation, state securities regulators and the SEC are also involved. The FRB has no responsibilities. The FIO’s monitoring responsibilities extend to conduct as well as financial regulation. The federal Consumer Financial Protection Bureau does not regulate insurance products.</p> <p>The states have an extensive set of requirements and processes for the regulation of conduct of business of insurers and intermediaries, including:</p> <ul style="list-style-type: none"> <li>• The producer licensing requirements (see ICP 18)—which address point of sale issues, since insurance products are mostly distributed through agents and brokers.</li> <li>• Rate and form regulation: departments exercise at least some review or approval authority over policy forms and, in the case of property and casualty insurers, they also often regulate premium rates; in some cases, insurers must simply file rates and forms before using them; in other cases, both must be approved in advance. In respect to rates, the objective is to ensure that they are not inadequate, excessive or unfair to consumers. For certain life insurance, annuity, disability and long term care products, a central approval process has been developed under the 2006 Interstate Insurance Product Regulation Commission (IIPRC) which 43 states have so far joined.</li> <li>• Requirements in insurance codes applicable to insurance business—drawn from the NAIC Unfair Trade Practices Act (#880) and Unfair Claims Settlement Practices Act</li> </ul>

	<p>(#900); the requirements focus on the prohibition of an extensive list of specific misconduct and of unfair trade and claims practices (see below); a number of other measures cover requirements on particular products—for example, the Suitability in Annuity Transactions Model Regulation and the Annuity Disclosure Model Regulation (see below), Long Term Care Model Regulation (model 641, subsections 8 and 9); Long Term Care Model Act (model 640, subsection 6.G); and Life Insurance Illustrations Model Act (model 582).</p> <ul style="list-style-type: none"> <li>• Market conduct examinations which departments undertake on individual companies and producers—which cover conduct issues in underwriting, claims handling, marketing and other areas (see ICP 9). There is an extensive Market Regulation Handbook published by the NAIC (which has a Market Regulation Department). This sets out guidance and procedures on market conduct examinations—which can generally be conducted under the authority of the Model Law on Examinations, as for financial examinations or under the powers of examination in the Unfair Trade Practices Act (a separate Market Conduct Surveillance Model Law (#693) has not been widely implemented).</li> <li>• Data collection from insurers on market conduct issues—the NAIC Market Conduct Annual Statement (MCAS), introduced in 2004 is used by companies (where implemented—now in 47 states) to report data such as length of time taken to settle claims and replacement rates for some product types (persistency)—product coverage is limited but expanding; it is used to target market wide responses and examinations and as input to the Market Analysis Working Group (MAWG), a cross-state group of around 16 state regulators that operates on similar principles to the FAWG. States have been increasing their market analysis capacity to respond to MCAS submissions and more generally to identify market conduct risks and issues, including through public information, promotions etc. States may also use ad hoc data calls and interrogatories.</li> <li>• Investigations into particular issues and products, for example recently FPI (force-placed insurance or the selling of add-on insurance coverage that may not be requested by the policyholder).</li> <li>• Databases to enable departments to record and retrieve information on producers and companies—such as the Regulatory Information Retrieval System (RIRS) and the Special Activities Database (SAD) which is used to check applicants’ background; and the Complaints Database System (CDS) covering closed complaints.</li> <li>• Direct consumer services, particularly complaints handling (also used as a source of insights into market conduct concerns) but also consumer information and consumer education programs. Departments analyze and respond to complaints, taking up issues with companies or producers and requiring redress where appropriate.</li> </ul> <p>As indicated (as has been noted in reports by the GAO and more recently by the FIO), implementation of these requirements and processes is not uniform across states. The NAIC accreditation program does not extend to market conduct. States may implement some of the measures through requirements which, though not “substantially similar” to model laws, achieve a similar result, but there are no data on the extent to which they have done so.</p> <p>Partly because of the divergence in requirements, concepts such as the lead state (see</p>
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ICP25) and coordination of examinations for multistate companies do not apply in the case of market conduct, as they do for financial analysis and examination.

Staff and other resources devoted to market conduct vary by state, but are in aggregate lower than for financial work (424 examiners, analysts and supervisory staff compared with 1,757 for financial), although states also engage over 600 staff for the handling of consumer complaints and 673 for rate and form regulation; and they make use of external contractors extensively for market conduct examinations (and more so than in financial examinations).

In relation to specific standards:

- There are no explicit standards to act with due skill and diligence—rather, the approach in the Unfair Trade Practices Act is to ban specific abuses and areas of misconduct such as misrepresentation of the benefits of an insurance policy.
- Insurers and intermediaries are not subject to explicit requirements to have policies on fair treatment of customers generally—the market conduct requirements are more specific and product-based in many cases; states address issues with culture through the examination process to the extent that they adopt the NAIC guidance in the Market Regulation Handbook, which identifies the importance of corporate culture in delivering compliance.
- Insurers are required to take account of customers' interests when developing particular products; issues may be identified and addressed as part of rate regulation, but requirements and examinations do not focus on the firm-wide product development process.
- Promotions are covered by the general ban on unfair and deceptive acts or practices and states do monitor for non-compliant promotions and respond to complaints. All advertisements are required to be truthful and not misleading in fact or by implication. (*Unfair Trade Practices Act, section 4A&B*).
- Point of sale disclosure requirements are covered by the Unfair Trade Practices Act and may be monitored in the course of rate and form regulation (i.e., product approval); the Annuity Disclosure Model Regulation sets out requirements on disclosure to customers for annuity sales at point of sale, including specimen illustrations.

On the regulation of advice to customers and suitability, the requirements on unfair practices are applicable and there are requirements in product-specific model laws, particularly the Suitability in Annuity Transactions Model Regulation.

This provides that in recommending to a consumer the purchase of an annuity (or the exchange of an annuity), the insurance producer or insurer must have reasonable grounds for believing that the recommendation is suitable on the basis of the facts disclosed by the consumer (the law sets out information that insurers should seek) and their financial situation and needs. It also requires insurers to review recommendations to purchase an annuity to determine suitability. The requirements do not apply where the customer solicits the sale directly.

There are fewer explicit requirements on suitability as opposed to customer disclosure, in relation to product types other than annuities.

A specific NAIC regulation, the Life Insurance and Annuities Replacement Model Regulation (#613) sets out requirements aimed at ensuring policyholders are treated

	<p>fairly when switching from one product to another, with one company or when transferring to a different company. Replacement rates on certain products are monitored via the MCAS and may be targeted in market regulation examinations.</p> <p>In respect of insurance claims handling, states require insurance claims to be settled in an equitable and fair manner. Specific acts listed as “unfair claims practices” include knowingly misrepresenting relevant facts or policy provisions relating to coverage, not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear; and attempting to settle or settling claims for less than the amount that a reasonable person would believe the insured or beneficiary was entitled by reference to material accompanying an application. There is an extensive list of unfair practices which are banned under the law. (<i>Unfair Claims Settlement Act</i>).</p> <p>Insurance regulators may levy civil penalties or take civil action in cases of unfair trade practices.</p> <p>There are no explicit standards on management by insurers and producers of conflicts of interest. State regulators would look at conflicts of interest via the examination process. Remuneration and incentives are not widely addressed in the requirements and guidance. However, the Market Regulation Handbook notes that in relation to annuities, examiners should review commission structure and note any differences between indexed and non-indexed annuity products that may provide an incentive to a producer to recommend one product over another regardless of suitability.</p> <p>Nor are there explicit standards on disclosures to customers after the point of sale (such as current cash surrender value of relevant policies) or on policies and processes that insurers and produces must have for handling complaints.</p> <p>On the privacy of customer information, insurers are subject to general U.S. law, although states have also developed specific legislation, including a model law Standards for Safeguarding Consumer Information Model Regulation (though this is not widely implemented). Insurers are required to have information security programs that include administrative, technical and physical safeguards for the protection of customer information.</p> <p>There is extensive publication on states’ websites of information on consumer risks, including warnings in relation to unauthorized business. The NAIC’s Consumer Information Source provide access to information about insurance companies, including closed insurance complaints, licensing information, and key financial data. Similar information is available on states’ websites. The NAIC and states conduct educational campaigns on fake insurance plans and support for consumers in making insurance decisions (the Insure U program).</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>There is an extensive body of requirements in relation to market conduct, much of it dating back many years and based substantially on the banning of certain unfair practices, requiring disclosure to customers and treating customers fairly; this is supplemented with specific requirements across the product range such as assessing suitability in relation to advice on sales of complex products.</p> <p>The comprehensive Market Regulation Handbook encompasses expectations on firms,</p>

	<p>including detailed material by types of insurance product, but does not create binding requirements. Market conduct examinations are being carried out, more regularly for insurers than for producers, and with a high degree of dependence on consultants to carry out the examinations in many states.</p> <p>There is a developing approach to market conduct risk analysis, although it is relatively lightly staffed. The states' approach remains in large part reactive, with a high degree of dependence on lagging indicators such as individual customer complaints. More focus on governance, culture (and the effect of incentives) and controls across the range of products, would be justified given that the U.S. market features complex products, mixed levels of financial literacy and a largely commission-based remuneration model.</p> <p>Aspects of the states' approach rely on NAIC processes (although without an accreditation process), including market analysis and the coordination of certain multistate efforts through MAWG. However, without greater uniformity in other areas such as the implementation of model laws, rate and form regulation and use of the Market Regulation Handbook, it is hard to assess whether market regulation is adequate across the states.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• states develop market conduct requirements that address the risks of unfair policyholder treatment across the range of insurance products and including requirements to treat customers fairly, to act with due skill and diligence, give suitable advice and to manage conflicts of interest;</li> <li>• states develop a risk-focused surveillance framework specifically for market conduct to support proactive, risk-based supervision of market conduct, covering both the supervision of individual firms and of issues that arise across the market;</li> <li>• states review staffing and resourcing models for market conduct regulation of insurers and producers, including scope to undertake more examination work using employees rather than consultants (see also ICP2 on resources); and</li> <li>• states continue to give consideration to developing an accreditation program for market conduct work (initial discussions have already been held), building on the work of the MAWG and on the comprehensive Market Regulation Handbook.</li> </ul>
<p><b>ICP 20</b></p>	<p><b>Public Disclosure</b></p> <p>The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.</p>
<p>Description</p>	<p>The requirements for disclosure to the public general apply only to publicly-traded companies, which are required to publish consolidated financial statement on a US GAAP basis.</p> <p>Insurance companies are not subject to formal requirements set by insurance regulators (states or FRB) on their disclosure of financial or other information. However, extensive amounts of information are made available in practice to the public in relation to insurance companies required to file statements via electronic means with the NAIC.</p>



	<p>These statements are made available to the public by the NAIC. Changes in NAIC reporting requirements feed directly into information available to the public.</p> <p>The quarterly and annual financial statements to state regulators contain information of use to stakeholders, including balance sheet information on assets and liabilities, income statements and cash flow projections. Attached are extensive notes, including general interrogatories, a summary of premiums (and losses for P&amp;C) by state, and holding company organizational chart.</p> <p>The annual statement adds detailed listings of investments owned, reinsurance transactions and various summary level schedules for premiums, claims and investment activity. Supplemental filings provide more detailed information for particular types of business such as interest sensitive products or accident and health policies—although some parts of the supplemental filing are confidential.</p> <p>Insurers disclose in their statements submitted to the NAIC information relating to risks and uncertainties, certain significant estimates, and on concentration risks. These disclosures are taken from the basis of GAAP disclosures, where US GAAP reporting is required.</p> <p>The statutory financial statements are filed electronically with the NAIC. Small, single-state insurers may be exempted from filing electronically but then have to file hard copies with the state regulator. Information has to be filed timely: the annual statement two months after year end, the quarterly statement 45 days after closing of the quarter. All filings are public.</p> <p>In addition, the NAIC publishes basic financial information and graphs for consumers.</p> <p>The financial statements are based on the NAIC Accounting Practices and Procedures Manual. States laws may differ due to prescribed accounting practices and permitted accounting practices are sometimes granted to individual insurers, material differences to the AP&amp;P capital and surplus and the net income must be disclosed in Note 1 of the Notes to Financial Statement.</p> <p>The financial statements are detailed and extensive and allow sophisticated users to obtain substantial information on reserving and capital adequacy:</p> <ul style="list-style-type: none"> <li>• Life insurance reserves are detailed in an exhibit which identifies the key regulatory requirements associated with those policies. P&amp;C insurers include Schedule P claims development triangles for many lines of business. The Notes to Financial Statement contain detail about accounting for major elements of the assets and liabilities. The regulatory standards for reserving are available to the public to assist in these disclosures.</li> <li>• The RBC is calculated based to a large degree on data contained in the financial statement. This allows the public to obtain detailed information to the exposures to risk of insurers. The Total Adjusted Capital and the Authorized Control Level RBC amount are disclosed in the 5-year historical data exhibit. Financial Statements contain extensive information on different classes of investment and notes disclosure key sensitivities, risks and accounting bases. US GAAP disclosures are less extensive in this respect but compensate with more qualitative discussions.</li> </ul> <p>The extensive financial statement and information on assets and liabilities allow the</p>
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	<p>analysis of asset-management based on public information.</p> <p>Financial filings contain less information on the company profile than US GAAP; however the extensive quantitative information allows users to deduce much about the companies' profiles and nature of business.</p> <p>Currently some corporate governance information exists in the statutory financial statement, but much of this is considered proprietary in the United States and thus is only available to the regulators. Additional disclosures regarding corporate governance practices to regulators are expected to be in place as of 2016, but again, this information will not be made available to the public.</p>
Assessment	Observed
Comments	<p>Publicly disclosed information is extensive and sufficient for sophisticated users (e.g. rating agencies and financial advisors) to gain information into the exposure to risks from investments and liabilities. Financial statements are filed electronically except for small companies, allowing the efficient analysis of the information. The use of off-balance sheet items has to be disclosed in notes. The use of complex structures, i.e. transfer of business to affiliated captives, where business is moved off-balance sheet reduces transparency and requires analysis by specialist. However, this is possible in principle.</p> <p>Insurance groups and insurance holding systems should be required to submit financial filings also on a consolidated level and this information should be made publicly available. This would give additional insight and useful information to the public as well as to regulators. While publicly traded groups have to file consolidated financial information on a US GAAP basis, statutory accounting would be useful not just for regulatory purposes but also for the public as the basis for analysis of exposure to risk.</p> <p>While public disclosure is extensive, its usefulness for decision making is hampered by the valuation standard it is based on (see ICP 14).</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>insurance groups and insurance holding systems are required to submit financial filings also on a consolidated level.</li> </ul>
<b>ICP 21</b>	<p><b>Countering Fraud in Insurance</b></p> <p>The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.</p>
Description	<p><b>Legal Framework</b></p> <p>The Insurance Fraud Prevention Model Act (#680) has been adopted by all States, which:</p> <ul style="list-style-type: none"> <li>sets out a prohibition on insurance fraudulent acts;</li> <li>gives investigative and other powers to the commissioner;</li> <li>establishes mandatory reporting to the regulator;</li> <li>provides for the confidentiality under law of relevant documents and information and for information to be shared with other agencies;</li> </ul>

- provides for the creation of fraud prevention units within departments; and
- requires companies to take antifraud initiatives to detect, prosecute and prevent fraudulent insurance acts.

Insurance fraud is a criminal offence under state laws.

State Antifraud Plan laws, regulations and bulletins require insurers to establish internal control framework for fraud prevention and reporting. Antifraud Plans detail the measures an insurer should take to prevent fraud and provide protocol when fraud is discovered.

The NAIC developed Antifraud Plan Guidelines and provided standards for insurers' Antifraud Plans : (1) a Special Investigative Unit has established criteria that will be used for the investigation of suspected fraud; (2) insurers will record the date that any suspected fraudulent activity is deterred; and (3) a written description or chart outlining the organizational arrangement of the insurer's antifraud positions responsible for the investigation and reporting of suspected fraudulent acts.

The insurer's or intermediary's Antifraud Plan must be filed with the state insurance regulator, and the state supervisor evaluates the plan through off-site monitoring and on-site examination. Many insurers and intermediaries have Special Investigation Units to identify and investigate suspicious claims and implement Antifraud Plans.

#### **Industry Collaboration**

State regulators and the NAIC are coordinating with insurers, intermediaries and industry associations to address and mitigate insurance fraud. There are six anti-fraud organizations that NAIC are coordinating regularly and one of them, the National Insurance Crime Bureau (NICB), works with insurers and law enforcement agencies to facilitate the identification, detection and prosecution of insurance crime. The NICB shares suspected fraud claims information with the NAIC who make it available to states.

The NAIC offers consumers and insurers the Online Fraud Reporting System (OFRS) in order to facilitate the mandatory reporting of suspected fraud. A report made in OFRS against an insurer or intermediary is delivered to all states in which the insurer or intermediary does business.

In 2010, state fraud bureaus received more than 132,000 case referrals from insurance companies, consumers and other law enforcement agencies and about 45,000 cases were opened for investigation, resulting more than 4,200 arrests and 2,000 civil actions.

#### **Supervisory practices**

State regulators conduct financial and market conduct examinations based on guidance provided in the NAIC Market Regulation Handbook and the NAIC Financial Condition Examiners Handbook. Such examinations are used to assess measures which insurers have in place to counter fraud as well as to detect fraud which may have occurred or is occurring within an insurer.

Most state regulators have fraud prevention units (or fraud bureaus), whose function includes initiation of independent investigations and reviews of reports or complaints of alleged fraudulent insurance activities from federal, state and local law enforcement and regulatory agencies and insurers. While examinations are conducted on a cyclical basis (typically every five years), targeted examinations could be conducted if necessary. The number of fraud investigators employed by state regulators has been increased in the

	<p>recent years.</p> <p><b>Cooperation</b></p> <p>State regulators maintain cooperative relationships with state and federal law enforcement agencies, Special Investigation Units of insurers, and independent antifraud associations. State regulators have statutory authority to share information regarding investigations, actions, and examination results with other insurance regulators and law enforcement agencies.</p> <p>State insurance departments have established protocols and department personnel dedicated to investigating and often prosecuting insurance fraud referrals when necessary. State insurance fraud bureaus have access to the Federal Bureau of Investigation Law Enforcement On-Line (LEO) website. This website contains training information related to insurance frauds. Through LEO, the state insurance fraud bureaus facilitate inquiries regarding suspicious activities with insurance policies in death or missing person cases.</p> <p><b>Enforcement</b></p> <p>An insurer or intermediary may be subject to a monetary penalty, suspension of a license, or revocation of a license if a fraudulent act has been committed. State regulators work with law enforcement agencies to facilitate prosecutions, if necessary. Investigators of 31 states and territories have peace authority (authority to place persons under arrest) and half of the state regulators have civil authority to impose fines.</p>
Assessment	Observed
Comments	State regulators address fraud-related issues by conducting market conduct exams to ensure that effective Antifraud Plans have been implemented by insurers. The availability of data on fraud has been improved significantly with the development of databases, which has resulted in number of enforcement actions.
<b>ICP 22</b>	<p><b>Anti-Money Laundering and Combating the Financing of Terrorism</b></p> <p>The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, and the supervisor takes effective measures to combat money laundering financing of terrorism.</p>
Description	<p><b>Legal and Institutional framework</b></p> <p>Insurance companies that issue or underwrite “covered products” (those that present a high degree of risk for money laundering, financing terrorism or other illicit activity) are subject to the relevant AML/CFT provisions of the Bank Secrecy Act (BSA). The Financial Crimes Enforcement Network (FinCEN) is responsible for supervising insurance companies for AML/CFT. Covered products include permanent life insurance policies (other than group policies), annuity contracts (other than group contracts), and any other insurance products with cash value or investment features.</p> <p>FinCEN has examination authority for AML/CFT but has delegated it for the insurance sector to the Internal Revenue Service (IRS). It retains enforcement authority, including referral of cases to criminal law enforcement agencies. The IRS is the default AML/CFT examiner for any non-bank financial institution (NBFI) that does not have a federal</p>

	<p>AML/CFT regulator (i.e., money service businesses; casinos and card clubs; credit unions that are state chartered and not federally-insured; insurance companies; and dealers in precious metals, stones, and jewels).</p> <p>For the insurance industry FinCEN has asked IRS to examine certain targeted companies for AML/CFT issues, but relies mostly on the state insurance regulators to review AML/CFT policies as part of their regular, standard examination. The IRS has approximately 270 examiners, of whom 20 are trained in insurance AML/CFT issues, but they also examine other NBFIs. The IRS has conducted 71 insurance examinations.</p> <p>The BSA and its implementing regulations require each insurance company that issues or underwrites “covered products” to file suspicious activity reports with FinCEN, keep records, and maintain an AML program applicable to its covered products.</p> <p>States also impose, and supervise compliance with their own AML/CFT requirements. The approach of the states recognizes that full scope examinations are undertaken by the federal authorities. However, state examiners may take account of AML/CFT issues in the course of their risk-focused financial examinations of insurance companies – examiners may review, for example, the company’s processes for compliance monitoring, seek copies of the company’s AML programs (as are required of insurers under the BSA), its risk assessments, independent test plans and the results of the testing performed. State regulators also cover AML record keeping and AML internal controls during examinations.</p> <p><b>Coordination, cooperation and exchange of information</b></p> <p>To cooperate and share information FinCEN has MOUs with 11 state regulators and relies on ad hoc arrangements with the other states and territories.</p> <p>The NAIC Financial Condition Examiners Handbook indicates that regulators conducting examinations should notify appropriate federal regulators if an insurer is not in compliance AML/CFT requirements.</p> <p>Some state regulators do actively share summaries of relevant examination results including reviews of companies’ AML programs with FinCEN. FinCEN also shares and exchanges information and coordinates with state regulators, including by discussing particular cases. FinCEN assigns an officer as a main contact point for state regulators and liaises with state regulators at NAIC meetings and other occasions.</p> <p>In addition, the FinCEN and the National Insurance Crime Bureau are working with the NAIC and state supervisors to further share information electronically from a variety of database systems. State insurance fraud bureaus have access to the Federal Bureau of Investigation Law Enforcement On-Line (LEO) website. This website contains training information related to a number of topics, including AML.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>While both federal and state authorities have roles in relation to AML/CFT regulations, key aspects of the U.S. regime for insurance are set out in the federal Bank Secrecy Act and accompanying regulations. FinCEN is the responsible federal authority, with the IRS having delegated authority for examinations, although there are plans over time for FinCEN to rely more on state regulators’ AML/CFT examinations. This would avoid duplication of examination effort, allowing redirection of scarce IRS resources (although it may still carry out targeted examinations of insurers), and recognize state expertise.</p>

	<p>State insurance supervisors already have an awareness of AML/CFT issues, resulting from their own supervisory work and liaison with federal authorities.</p> <p>Cooperation in practice between federal regulators and the states appears good. FinCEN, State Regulators and NAIC have established MoUs and are cooperating to share relevant information. There are currently 11 MoUs completed between FinCEN and state regulators. FinCEN plans to expand its information-sharing MoU network to additional states, supplementing its current outreach action plan and regular attendance at NAIC meetings.</p> <p>Exchange of information can and does take place without a MoU, and there are no legal restrictions on such exchanges. However, it is recommended that to help ensure there is active and effective information sharing on AML/CFT, FinCEN, state regulators and the NAIC continue to expand the network of MOUs and speedily implement the ongoing project for electronic information exchange.</p>
<p><b>ICP 23</b></p>	<p><b>Group-wide Supervision</b></p> <p>The supervisor supervises insurers on a legal entity and group-wide basis.</p>
<p>Description</p>	<p>The supervision of US insurance groups is divided between state regulators and the FRB. The FRB is responsible for the regulation and supervision of SLHCs and of NBFCs designated for FRB supervision by the Financial Stability Oversight Council (FSOC). States are responsible for the supervision of legal entities within all insurance groups, as part of which they undertake supervision of the groups (or “holding company systems”).</p> <p><b>Group supervision by the FRB</b></p> <p>The relevant laws are the Bank Holding Company Act, Dodd-Frank Act, and the Home Owners' Loan Act, which governs SLHCs, among others.</p> <p>Regulations implementing those statutes include the Federal Reserve’s Regulation Y (12 CFR Part 225) and Regulation LL (12 CFR Part 238), among others. The Dodd-Frank Act transferred the supervision of SLHCs, including their non-depository subsidiaries beginning in July 2011 from the Office of Thrift Supervision to the FRB. Consolidated supervision responsibility, particularly from the resolution perspective, is also derived from Titles I and II of the Dodd-Frank Act, which refer to financial stability and orderly liquidation.</p> <p>As of the end of 2013, there were over 50 insurers in 15 groups within the scope of the FRB supervision of SLHC. Currently three NBFCs have been designated to be regulated by the FRB: AIG, Prudential Financial and General Electric Capital (not an insurance group). AIG and Prudential are supervised as part of the LISCC portfolio (described below). The AIG on-site team is provided by FRB New York and the Prudential on-site team by FRB Boston.</p> <p>All SLHCs and NBFCs are subject to supervision by the FRB on a consolidated basis, which encompasses the parent company and its subsidiaries.</p> <p>Principles for the supervision are outlined in a number of Supervisory letters and the Federal Reserve Bank Holding Company Supervision Manual. The focus of the FRB is the safe and sound operation of the SLHC and its subsidiary depositor institution(s). For NBFCs, the consolidated supervisory framework has two primary objectives:</p> <ul style="list-style-type: none"> <li>• Enhancing resiliency of a firm to lower the probability of its failure or inability to</li> </ul>

<p>serve as a financial intermediary. This is supported by expectations on capital and liquidity planning and position; corporate governance; recovery planning and the management of core business lines.</p> <ul style="list-style-type: none"> <li>• Reducing the impact on the financial system and the broader economy in the event of a firm’s failure or material weakness. This is supported by expectations on the management of critical operations, support of banking offices; resolution planning and additional macroprudential supervisory approaches to address risks to financial stability.</li> </ul> <p>The largest, most complex financial institutions subject to consolidated supervision are included in the portfolio overseen by the Operating Committee of the Large Institution Supervision Coordinating Committee (LISCC). The LISCC is a multidisciplinary body that oversees supervision and evaluates the conditions of supervised firms. It has a cross-firm perspective and monitors interconnectedness and common practices that could lead to greater systemic risk.</p> <p>The FRB assigns a senior supervisory officer to each designated insurance firm as the lead examiner. The officer spends significant time with senior management and the board of directors to understand how risk management is integrated within the firms. Business line specialists are assigned to material business lines and work closely with risk specialists within the FRB. Currently about 14 examiners are assigned to AIG, and the FRB expects to extend the team to about 20 people. The supervisory approach is to be on-site often and have frequent discussion with risk managers and senior executives.</p> <p>The FRB uses different supervisory approaches to assess designated firms under consolidated supervision:</p> <ul style="list-style-type: none"> <li>• Coordinated horizontal reviews which involve examination of several institutions simultaneously, encompassing firm-specific supervision and the development of cross firm perspectives.</li> <li>• Firm-specific examination and continuous monitoring activities.</li> <li>• The reliance—as far as possible—on information and assessments provided by other relevant supervisors and functional regulators.</li> <li>• In certain instances, supervisors may be able to rely on a firm’s internal audit or internal control functions in developing a comprehensive understanding and assessment.</li> </ul> <p>As part of the horizontal reviews and of the capital planning and stress testing program, the FRB conducts annually the Comprehensive Capital Analysis and Review (CCAR) exercise for banks. It is expected that large nonbank financial institutions will also fall within the scope of CCAR. The FRB is also starting to develop stress tests to also cover risk specific for insurers. The FRB conducts a sophisticated stress testing regime, encompassing several stress tests defined by the FRB (baseline, adverse and severely adverse scenarios) as well as the requirement for institutions to define and evaluate two firm-specific stress tests (a baseline and stress scenario).</p> <p>Currently the CCAR is not yet a requirement for nonbank financial institutions and will be imposed only when the FRB has defined its capital standards for the insurance groups which it supervises. As discussed in the assessment of ICP17, the FRB is currently in the process of developing such standards, taking into account recently enacted legislation in the United States which would give the FRB flexibility to set appropriate capital</p>
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	<p>standards for insurance groups.</p> <p><b>Group supervision by the state regulators</b></p> <p>The supervision of insurance groups and holding companies by state regulators is based on the Insurance Holding Company System Regulatory Act (MDL 440) which relates to powers over the group and the Insurance Holding Company System Model Regulation Act (MDL 450) which relates to examinations and analysis.</p> <p>The Risk Management and Own Risk and Solvency Assessment Model Act (MDL 505) and the NAIC Own Risk and Solvency Assessment (ORSA) Guidance Manual define expectations relating to ORSA and will be in force in states that have implemented the model law as of 2015. The Financial Analysis Handbook and the Financial Condition Examiners Handbook give further guidance on expectations that state regulators have on legal entities and groups and on the supervisory approach.</p> <p>All states have enacted a version of an insurance holding company law substantially similar to the Model Holding Company Act. State insurance regulators adopted revisions to this model in 2010, giving the state insurance commissioner authority, though not the requirement, to obtain consolidated financial reports. The revisions also require an enterprise risk report for the full holding company structure, clarify regulatory access to holding company information, and enable the regulators to more easily participate in supervisory colleges. 38 states have adopted the revisions to the Model Holding Company Act.</p> <p>MDL 440 clearly defines the scope of the group subject to supervision. The scope of a group includes the ultimate controlling party and all other entities controlled by that party. MDL 440 and 450 give states authority to monitor and review the financial state of insurance holding company systems.</p> <p>MDL 440 states that the commissioner has the power to examine any insurer and its affiliates to ascertain the financial condition of the insurer, including the enterprise risk to the insurer posed by the ultimate controlling party or by any other entity or combination of entities within the insurance holding company system or by the insurance holding company system on a consolidated basis. This power is restricted to the insurer and gives the supervisors powers over the ultimate holding company only indirectly (by contrast, the FRB's powers relate directly to the holding company itself).</p> <p>There are no public disclosure requirements for financial statements on a group level for groups that are not publicly traded.</p>
<p>Assessment</p>	<p>Partly Observed</p>
<p>Comments</p>	<p>Group supervision has been improved and strengthened. The Insurance Holding Company System Model Regulation Act allows state regulators to supervise insurance groups. The FRB can exercise consolidated supervision over SLHC and NBFC. Supervisory colleges have been put in place and are active.</p> <p>For state regulators, the regulation and supervision of groups would be facilitated if they were provided with direct legal authority over the insurance holding company. To assess an insurance group or holding as a whole, it can be necessary to analyze the interaction of the ownership structure of the entity with the web of intra-group transactions. This</p>



	<p>requires information and supervisory authority potentially also in respect to non-insurance entities and holding companies. This can occur under many situations, e.g. when a parental guarantee of a holding company cannot be honored in a financial stress situation because of its over-commitment towards other non-insurance legal entities.</p> <p>As discussed in ICP1, the potential conflicts between the objectives of the different supervisory authorities involved should be identified and addressed. The FRB aims for protection of depositors in the supervision of SLHCs while state regulators supervising the SLHC's insurance legal entities focus on policyholder protection. Equally for large nonbank financial institutions, the FRB's objective is to prevent or mitigate risks to the financial stability of the United States while state regulators again focus on the protection of policyholders.</p> <p>There are no group-level capital standards in place, neither for groups supervised by state regulators nor for SLHCs and NBFCs supervised by the FRB. State regulators should be provided with the authority to set group-wide valuation and capital requirements and the FRB should develop a valuation and capital standard speedily. The analysis and the assessment of a group's financial position in the current and in stressed situations ultimately require an appropriate valuation and capital standard. Without such a standard, the impact of the web of intra-group transactions, the transmission of losses through the group and the failure mode of the group cannot be evaluated soundly.</p> <p>Resolution planning might be workable without a sound capital framework by assuming a—possibly unrealistic—catastrophic loss across the entire group. By contrast, a regulatory framework that aims for policyholder protection has to consider events that are catastrophic for insurance legal entities but possibly not for the group as a whole. This implies the ability to assess the impact of intra-group transactions, limited capital mobility, the solvency position of different legal entities within the group and more. This requires a sound capital standard that is able to capture the performance of intra-group transactions, i.e. in which situation they are triggered and if the guarantor is able to honor the commitment.</p> <p>It will be important that the development and implementation of capital standards for groups supervised only by state regulators and for those supervised on a consolidated level by the FRB are consistent. Lack of consistency would introduce further regulatory arbitrage opportunities and competitive distortions.</p> <p>A stress testing regime for insurance groups and holding companies would support state regulators in assessing risks within groups they supervise. In the absence of a group-wide valuation and capital standard, stress testing—if defined appropriately—would help state regulators to gain insight into the exposures to risk of its entities.</p> <p>The FRB might consider developing and implementing a framework to assess the impact of intra-group transactions. Complex, large insurance groups with hundreds or thousands of legal entities can only be understood if the impact of the group structure with the web of intra-group transactions is analyzed appropriately.</p> <p>There are no group wide investment, market conduct and disclosure requirements in place.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• state regulators obtain direct legal authority over the insurance holding company (although this is beyond the current ICP);</li> </ul>
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	<ul style="list-style-type: none"> <li>• capital standards are put in place in a consistent manner, for group supervised by state regulators and by the FRB;</li> <li>• potential conflicts of interests of different supervisory authorities are identified and clarified;</li> <li>• a stress testing regime for insurance groups and holding companies be implemented;</li> <li>• consolidated financial statements are published by all insurance groups; and</li> <li>• investment activities at the group level are carefully monitored to address potential regulatory arbitrage and search for yield at the group level.</li> </ul>
<p><b>ICP 24</b></p>	<p><b>Macroprudential Surveillance and Insurance Supervision</b></p> <p>The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilize information from, and insights gained by, other national authorities.</p>
<p>Description</p>	<p>There are a number of supervisory authorities and institutions involved in macroprudential surveillance.</p> <p>The Dodd-Frank Act established the Federal Insurance Office (FIO) within the US Treasury Department. In addition to its other statutory authorities, FIO monitors all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system. In its annual report, it identifies current issues and emerging trends concerning the insurance industry and analyses the impact of e.g., low interest rates, natural catastrophes and changing demographics. It is a member of the IAIS Financial Stability Committee and in work streams related to the identification of G-SIIs.</p> <p><b>The Financial Stability Oversight Council</b></p> <p>The Dodd-Frank Act also established the Financial Stability Oversight Council (FSOC) and charged it with three primary purposes:</p> <ul style="list-style-type: none"> <li>• To identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace.</li> <li>• To promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the U.S. government will shield them from losses in the event of failure.</li> <li>• To respond to emerging threats to the stability of the U.S. financial system.</li> </ul> <p>FSOC has the authority to designate an NBFC for supervision and enhanced prudential standards by the FRB if the FSOC determines that its material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company, could pose a threat to U.S. financial stability. Currently AIG and Prudential Financial have been designated. MetLife—which is a G-SII—has stated that it has been preliminarily designated.</p>

To support the FSOC, Congress created the Office of Financial Research (OFR) to collect systemic data and analysis. It is responsible for collecting information from agencies represented on the FSOC, other federal and state regulatory agencies, the Federal Insurance Office and potentially from bank holding companies and nonbank financial companies directly, to help assess risks to the US financial system.

The FSOC consists of 10 voting and 5 non-voting members. Among the voting members is an independent member with insurance expertise who is appointed by the President and confirmed by the Senate for a six-year term. Among the 5 non-voting members is the Director of the FIO and one state insurance commissioner.

The FSOC members meet regularly and discuss risks and potential threats to the US financial system. Their analysis and findings are published in an annual report. The latest annual report identified for example risks to insurance companies from increased interest rate volatility as an emerging risk.

### **The Federal Reserve Board**

The FRB is also engaged in macroprudential surveillance on many levels. Nonbank financial institutions are part of the LISCC portfolio within the FRB's Division of Banking Supervision and Regulation, bringing an interdisciplinary and cross-firm perspective to the supervision of large systemically important financial institutions.

The FRB established the Office of Office of Financial Stability and Research (OFS) to help the FRB more effectively monitor the financial system and develop policies for mitigating systemic risks. The OFS is responsible for coordinating and supporting the Board's work on financial stability. In conjunction with other Board divisions, it identifies and analyzes potential threats to financial stability; monitors financial markets, institutions and structures; and assesses and recommends policy alternatives to address the threats. In addition, the office aims to foster broader understanding of financial stability issues by undertaking longer term research, primarily in banking, finance, and macroeconomics.

The FRB conducts the annual Comprehensive Capital Analysis and Review (CCAR) exercise. Firms are required to conduct stress tests based on company-specific scenarios and scenarios that are defined by the FRB.

### **State Regulators and the NAIC**

States and the NAIC—as the FRB—are involved in macroprudential surveillance on different levels. The NAIC's Financial Regulatory Services and Capital Markets Bureau are charged with monitoring and gathering data on insurers' activities and considering broader market factors that could have an impact on insurers, individually, as a group, or as an industry. The NAIC also set up the Financial Stability Task Force with the mission to consider issues concerning domestic or global financial stability as they pertain to the role of state insurance regulator. The NAIC currently also holds the vice chair of the IAIS Financial Stability Committee and the chair of the Macroprudential Policy and Surveillance Subcommittee.

The NAIC's Financial Analysis Working Group (FAWG) analyzes nationally significant insurers and groups that might become or already are financially troubled and advises supervisors on appropriate actions. It also supports, encourages, promotes and coordinates multi-state efforts in addressing solvency problems, including identifying adverse industry trends. The NAIC also set up the Center for Insurance Policy and Research (CIPR) also analyses and discusses emerging risk, e.g. on electromagnetic

	<p>pulses, on the potential systemic risk of life insurers' investment decision and more.</p> <p>The NAIC is able to analyze the data from the detailed and extensive quarterly and annual submission of all insurers and track it over time. It is able to run ad-hoc stress tests or what-if analysis and identify potential exposures to risk of the insurance industry.</p>
Assessment	Largely Observed
Comments	<p>There are a number of regulatory authorities and other bodies involved in macroprudential surveillance and insurance supervision. The sophistication of the macroprudential framework is not yet congruent with the complexity of the US financial sector. There is further scope for the surveillance on interlinkages between financial sectors, exposures to systemic risks and interactions of different regulatory systems. The insurance industry is highly exposed to system-wide risks, e.g. low-interest rates or the failure of a systemically important bank, which should be analyzed and appropriate macroprudential measures taken.</p> <p>The FIO, FSOC the FRB and the NAIC combined constitute a framework for macroprudential surveillance and insurance supervision. There are numerous agencies and offices analyzing data and engaging in research on systemic risk and macroprudential issues. However, macroprudential work relevant to insurance sector is still in a developing stage.</p> <p>The cooperation of different authorities and offices can be improved on macroprudential issues relevant to insurance sector. There is likely to be some duplication of efforts and a pooling of resources might increase the overall quality. As an example, the FRB is aiming to develop insurance specific stress tests and might in this benefit from closer cooperation with the states and the NAIC.</p> <p>Delivering appropriate representation for insurance at the FSOC has been complicated by the fragmentation of responsibilities for insurance supervision and oversight. As a result, the sector is not represented by individuals equipped to speak with authority and responsibility for the full sector. This is unlikely to be possible without further changes to the regulatory architecture. The Box in the introduction to this assessment considers possible reforms aimed at providing for stronger coordination and consistency across U.S. insurance regulation.</p> <p>The concept of systemic relevance for NBFC should be clearly defined by the FSOC. Such a definition would support also the analysis of the FSOC and the OFR on emerging threats and the identification of risks to the US financial system. Stress testing and crisis management exercises that the FRB is assigned to would provide good insight of systemic implication of NBFC.</p> <p>The states and NAIC might consider introducing a stress testing regime. A formal, regular stress testing framework for the insurance industry would give valuable information. Ideally, for financial market stresses, the framework would be aligned as far as feasible to the FRB CCAR framework. This would give additional insights into cross-sectorial interlinkages.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• different authorities and offices work closer together on macroprudential issues;</li> <li>• the FSOC encourage the FRB to develop stress testing and crisis management</li> </ul>

	<p>exercises which are meaningful to insurance sector and clearly defines the concept of systemic relevance for NBFC; and</p> <ul style="list-style-type: none"> <li>the representation of the insurance sector is brought in line with other sectors within FSOC.</li> </ul>
<p><b>ICP 25</b></p>	<p><b>Supervisory Cooperation and Coordination</b></p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.</p>
<p>Description</p>	<p>In the nature of a state-based insurance supervisory system, with companies increasingly operating in multiple states, there is a particular need for effective supervisory coordination in the US, while some groups also have extensive foreign operations.</p> <p><b>Domestic cooperation</b></p> <p>Domestically, the coordination of supervisory activity is the responsibility of the lead state supervisor. Decisions on which state is to lead are taken collectively by the domestic state regulators of the group (i.e., supervisors in states where the group’s legal entities are incorporated). They take account not only of the domiciliary state of the parent or largest insurance company, but also the physical location of the main corporate offices or largest operational offices of the group, states’ knowledge of the various business attributes and structures, and affiliated arrangements or reinsurance agreements. <i>(NAIC Financial Analysis Handbook, section 4E Holding Company Analysis).</i></p> <p>The lead state is responsible under the NAIC accreditation standards for undertaking the holding company analysis where a company is part of a holding company system. The lead state will also typically coordinate supervisory work (leading multistate examinations) and chair the supervisory college for relevant U.S. groups. Lead state supervisors are in place for all groups.</p> <p>There is no prescribed set of roles and responsibilities for lead states, other than holding company analysis. The NAIC Financial Analysis Handbook suggest the following additional lead state activities:</p> <ul style="list-style-type: none"> <li>the establishment of procedures to communicate information regarding troubled insurers with other state insurance departments;</li> <li>participation on joint examinations of insurers;</li> <li>assignment of specific regulatory tasks to different state insurance departments in order to achieve efficiency and effectiveness in regulatory efforts and to share resources and expertise;</li> <li>establishment of a task force consisting of personnel from various state insurance departments to carry out coordinated activities; and</li> <li>coordination and communication of holding company system analysis.</li> </ul> <p><i>(NAIC Financial Analysis Handbook, section VII, Appendix A, Holding Company and Supervisory College Best Practices).</i></p> <p>Information-sharing procedures between states are a component of the NAIC accreditation standards and accreditation program as is holding company analysis, but the wider role and effectiveness of the lead state regulator is not addressed.</p>

Lead states may coordinate regular discussions amongst U.S. supervisors in between meetings of the supervisory college, where relevant. They have a key role in coordinating work on proposed change in control and on multi-state troubled companies, including coordination with foreign regulators, if any.

A key role in practice for lead states is the coordination of the regular examinations. Although states have long been able to rely on financial examinations undertaken by another state where that state is accredited, this has not always led to coordination of examinations of multi-state firms or to the adoption of a group-wide approach to examinations. The lead state system, coupled with pressures for increased efficiency, has helped to deliver a more coordinated approach in recent years (see also ICP9).

The lead state also leads on coordination between insurance regulators and bank supervisors. For all SLHCs and NBFCs, there is an identified state insurance regulator (e.g., New York for AIG and New Jersey for Prudential) which is the key interface with the relevant Federal Reserve Bank, although other states may also be involved in discussions with the Fed, depending on the issue, including through the supervisory college.

For the SLHCs and NBFCs, the FRB does not seek to replace or override the role of the lead state regulator (and is required by law to rely as far as possible on state supervisors' work). It works in parallel with the lead and other states, coordinating with the lead.

Both state and FRB regulators may invite the other to participate in joint examination work. Such work has been limited to date. The FRB has access to insurance companies' financial statements and most states also provide the FRB with quarterly and annual analysis work papers, but the FRB also obtains state offsite analysis and examination work papers when requested. It does not participate in the work of the FAWG peer review and other NAIC processes related to financial analysis and examination.

The extent of exchange and cooperation between state regulators and the FRB was reported to the assessors as varying by insurance group and by team.

### **International cooperation**

Supervisory colleges have been established in recent years for all U.S. insurance groups meeting the definition of an Internationally-Active Insurance Group (IAIG) developed by the International Association of Insurance Supervisors (IAIS).

22 U.S. group colleges now meet, at different frequencies, including colleges for the NBFCs. Colleges are chaired by the lead state supervisor, who assumes the role of Group-Wide Supervisor (GWS), but may also be chaired by the FRB for the SLHCs and NBFCs. Crisis Management Groups are also meeting for the NBFCs (see ICP26).

The NAIC has developed guidance for the establishment and management of supervisory colleges, drawing on the IAIS Guidance Paper on the Use of Supervisory Colleges in Group-Wide Supervision. This emphasizes that supervisory colleges need to be viewed as part of the risk-focused surveillance process as well as the need for college work to include crisis preparedness. (*NAIC Financial Analysis Handbook, section VII, Appendix A, Holding Company and Supervisory College Best Practices*).

Membership of supervisory colleges generally comprises the major U.S. state regulators, the FRB and all foreign regulators, if they choose to participate (CMGs, by contrast are smaller groupings, with foreign regulators of the major parts of the group only). The FIO participates in CMGs but not in colleges. Some states have explicit thresholds for participation, expressed in terms of the size of the business in the United States and its

	<p>share of the host country market.</p> <p>Colleges for U.S. groups generally operate on the basis of terms of reference agreed by the members (on the initiative of the U.S. chair), which define expectations of the purpose of the college, set out membership and identify the GWS as well as specifying roles and responsibilities, scope of activities, frequency of meetings etc.</p> <p>Colleges are new and have been focusing to date on information-sharing amongst regulators, including on national regulatory regimes and group structures and activities, and on meetings and presentations from the senior management of the insurance groups.</p> <p>A review by the assessors of one college file highlighted that the state regulator, as the GWS, was responding to information requests etc. from host regulators. U.S. regulators, including the FRB, value the process and the outputs to date, including coordination of work. Companies which met with the assessors reported that they had participated and received feedback and follow-up questions from colleges.</p> <p>Supervisory colleges have not yet developed a structured, shared view of group-wide risks, group-wide governance and risk management or (absent a U.S. or global group-wide capital standard) a view on the financial condition of the group.</p> <p>State regulators are also members of 12 supervisory colleges for insurance companies operating in the United States which have foreign parent companies. It is the role of the lead state regulator to act as U.S. contact for foreign regulators and to be available to respond to requests for information, for college meetings and conference calls etc. (<i>NAIC Financial Analysis Handbook, section VII, Appendix A, Holding Company and Supervisory College Best Practices, section IIIA</i>).</p> <p>In practice, state regulators take a view on how much resource they will devote to colleges where they are the host supervisor, taking into account the materiality of the business in the United States and the importance of the U.S. business to the group as a whole.</p> <p>International cooperation and the work of supervisory colleges is not an accreditation standard, although the supervisory college requirements in the holding company model acts will become an accreditation requirement as of January 1, 2016. The revised NAIC Insurance Holding Company System Regulatory Model Act gives states explicit authority to participate in supervisory colleges and is already in force in the 38 states which have adopted it to date. This has not prevented states from establishing and participating in colleges in practice, even where the state has not yet adopted the revised holding company legislation.</p>
<p>Assessment</p>	<p>Largely Observed</p>
<p>Comments</p>	<p>U.S. insurance regulation has developed a significantly stronger focus on domestic and international supervisory coordination in recent years. This reflects the states' development of the holding company analysis framework; the growth in supervisory colleges under the IAIS framework; and the strengthening of SLHC supervision, and addition of group-wide NBFC supervision by the FRB, which has become the lead regulator (Group-Wide Supervisor) of the groups which it supervises.</p> <p>At the state level, the lead state concept is now embedded in the regulatory system and is delivering stronger coordination, including on troubled companies. However, there</p>

	<p>remain limitations on cooperation between state regulators, which partly reflects the lack of uniformity in regulatory approaches.</p> <p>State regulators' cooperation with FRB supervisors is developing, based on a complementarity of approaches (legal entity and group focus), although the FRB role is still relatively new and relationships in practice have further to develop for some groups.</p> <p>The absence of U.S. or global group-wide capital standards (see ICP23) constrains to an extent the lead state holding company analysis process as well as the FRB's group-wide supervision and the work of the colleges; but U.S. regulators have not let this prevent the establishment and effective functioning of supervisory colleges in an information-sharing and coordination role.</p> <p>It is recommended that:</p> <ul style="list-style-type: none"> <li>• states and the FRB review how to develop stronger cooperation between U.S. insurance supervisors, which could include increased joint working (e.g., on-site work), secondments and appropriate training; and the FIO and NAIC work more closely together, for example to develop a shared view on priorities for modernization of insurance regulation;</li> <li>• that state regulators and FRB set objectives for colleges to move to the next level of cooperation, including potentially the development of a shared group risk assessment similar in purpose to the insurance group profile and joint working; and consider whether this may require sub-groups of members or colleges to meet in a core group format to promote efficient working; and</li> <li>• states fully and effectively incorporate the state regulators' collective expectations on international supervisory colleges into the accreditation program.</li> </ul>
<p><b>ICP 26</b></p>	<p><b>Cross-border Cooperation and Coordination on Crisis Management</b></p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.</p>
<p>Description</p>	<p>Cross-border cooperation and coordination is handled by U.S. regulators through:</p> <ul style="list-style-type: none"> <li>• colleges of supervisors established and led by the U.S. regulator, which are in place for all groups meeting the IAIS definition of an internationally active insurance group; most state regulators, the FRB, where it has supervisory responsibilities, and most (or in some cases) all foreign supervisors participate in the colleges; and</li> <li>• Crisis Management Groups—which have been (or in one case was expected at the time of the assessment soon to be) established and meeting under FRB chairmanship for the NBFCs. The FDIC and FIO are also members, reflecting the role which they may have in the resolution of NBFCs under Title II of the Dodd-Frank Act, as well as major state regulators and supervisors from the foreign jurisdictions where major operations are conducted—i.e., representation from domestic and foreign supervisors is more limited than for colleges.</li> </ul> <p>State regulators also participate in colleges and CMGs established by foreign supervisors for groups with a significant U.S. presence.</p> <p>State and federal authorities have adequate powers to share information with each other</p>



<p>and with foreign regulators in order to coordinate preparations for the management of a crisis management and coordination (see also ICP2 and ICP3).</p> <p>State regulators have had experience since the financial crisis of dealing with cross-border insurance companies facing serious difficulties. Receivership action has not been required of the U.S. regulators in such cases and cross-border crisis management arrangements have crisis management arrangements have not yet been fully applied in practice owing to the lack of cross-border receiverships (although there have been a number of domestic insurance company failures).</p> <p>However, coordination with the foreign regulator of the parent company of the U.S. entities appears to have been effective in one particular case—for example, in ensuring that state and foreign regulator were kept informed through the mechanism of the lead state regulator in the United States (see ICP25) and in preventing action by an individual regulator that could have jeopardized the successful management of the crisis.</p> <p>Colleges of supervisors have held initial discussions of crisis preparedness (including exchange of key contact information etc.) and crisis management arrangements; and U.S. regulators have shared information about group structures. Colleges have generally focused to date on information-sharing and building a shared view of the risks in the group. Detailed discussions on, for example, the implications of intra-group transactions and of barriers to effective crisis management in practice have not generally occurred yet (but see below on NBFCs).</p> <p>Supervisors have not explicitly required that companies (in general, or those subject to the supervisory college process) are able to supply on a timely basis information that would be needed for the authorities to manage a crisis (ICP26.5). Regulators would rely on their general powers to require information, if needed. However the exercise of such powers during a crisis may not result in timely production of urgently required information (regulators believe that the group would already be monitoring relevant information).</p> <p>State regulators do not have requirements on insurers generally to maintain contingency plans in case of crisis.</p> <p>In respect to the NBFCs, resolution plans (“living wills”) have been prepared by both groups covering their global operations, as required under the Dodd-Frank Act, and these have been submitted to the FRB and FDIC. They are also being shared by the FRB and FDIC on request with the CMG member state regulators of the NBFCs but have not as yet been shared and discussed within the CMG itself. Analysis of the plans by the federal authorities and feedback to the groups has been limited to date.</p> <p>There is a set of requirements and processes in the Act that apply to all large institutions subject to FRB oversight:</p> <ul style="list-style-type: none"> <li>• The FRB and FDIC do not approve resolution plans, but they may jointly find a plan is not credible or would not facilitate an orderly resolution in bankruptcy.</li> <li>• If a resolution plan is found to have deficiencies, the company will have 90 days to resubmit; if deficiencies are not corrected, the firm may under the law become subject to more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations.</li> <li>• Resolution plans may not rely on extraordinary government support.</li> </ul>
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	<p><i>(Dodd-Frank Act, Section 165)</i></p> <p>These requirements are not tailored to insurance companies, where necessary (for example in relation to measures to be taken in case the plan is inadequate).</p> <p>Company-prepared plans for large institutions supervised by the FRB are generally used to support the FDIC's planning for the exercise of its resolution powers.</p> <p>As mentioned in more detail in the assessment of ICP12, under Dodd-Frank Act, Title II, insurance companies and groups would generally expect to be resolved under the U.S. Bankruptcy Code or otherwise applicable insolvency law, which for licensed insurance companies is state insurance insolvency laws. Title II of the Act also allows for a separate process when systemic risk is potentially at issue and a systemic risk determination has been made by the Secretary of the Treasury. Resolution of an insurer would still take place under state law under this process. However, a holding company of an insurance group that is not itself licensed as an insurance company could be resolved in these circumstances using the specific Dodd-Frank Act resolution powers. <i>(Dodd-Frank Act, section 203).</i></p> <p>The FIO and the FDIC are beginning to work with the state regulators and with state guaranty associations better to understand how the current state-based arrangements for resolution of insurance companies operate in practice.</p>
Assessment	Largely Observed
Comments	<p>The U.S. authorities' approach to cross-border crisis management and coordination is at an early stage of development, reflecting the recent establishment of colleges of supervisors and, for the two NBFCs, Crisis Management Groups. The application to the NBFCs of much of the same framework as applies to other large financial institutions under Dodd-Frank has brought early progress, rigor and consistency to the process for resolution plans ("living wills").</p> <p>Outside the college framework (which is generally limited to IAIGs), U.S. supervisors have coordinated with both foreign and multiple U.S. state jurisdictions in the management of a troubled company effectively, although the crisis did not extend to a failure of any company involved.</p> <p>There appears scope for using the colleges (or smaller groups of college members as for the CMGs) to undertake crisis preparedness, including more sharing of information on group structures, intra-group transactions and potential barriers to effective crisis management. Supervisors should ensure that all internationally-active groups have developed contingency plans and are able to deliver information that may be required in a crisis in a timely fashion.</p> <p>In relation to resolution, including the operation of Dodd-Frank Act processes for the management of a crisis where systemic risk is potentially at issue and there has been a systemic risk determination, work is also an early stage. The capacity of the authorities to manage a resolution of a cross-border insurance group will need further development.</p> <p>It is recommended that the authorities continue their work in relation to crisis preparedness, giving priority to building on the work of the CMGs (and current work at the FSB and the IAIS) to develop their planning for a crisis and resolution of a major cross-border group.</p>

