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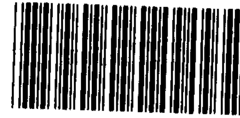

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Insurance Regulation: Assessment of the National Association of Insurance Commissioners

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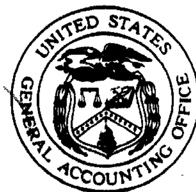
Before the
Subcommittee on Policy Research and Insurance
Committee on Banking, Finance, and Urban Affairs
U.S. House of Representatives



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Insurance Regulation: Assessment of the National Association of Insurance Commissioners

SUMMARY OF STATEMENT BY
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At the Subcommittee's request, GAO is presenting its assessment of the capability of the National Association of Insurance Commissioners (NAIC) to create and maintain an effective national system for solvency regulation.

GAO's work on the regulation of the various components of the financial services industry has identified important similarities in the basic principles that underlie effective regulation. To effectively create and maintain a national system of insurance regulation, a regulatory organization would need authority to perform several essential functions, including the authority to

-- establish rules for the safe and sound operation of insurers;

-- establish minimum standards for effective solvency regulation by state insurance departments;

-- monitor the functions of state insurance departments; and

-- compel the enforcement by state regulators of the rules for safe and sound operation, and the adoption and application by states of minimum standards for effective solvency regulation.

While recognizing NAIC's good intentions, GAO does not believe that NAIC can successfully establish a national system of uniform insurance regulation because it does not have the authority necessary to require states to adopt and enforce its standards. Furthermore, GAO does not believe that NAIC can be effectively empowered either by the states or by the federal government to exercise the necessary authority. Empowerment by the states would require that each state legislatively cede part of its authority to NAIC. However, even if each state chose to do this, NAIC's standing as a regulator would always be weak because the ceded authority would be subject to revocation at any time by each state's legislature. In effect, NAIC would regulate at the pleasure of those it regulates.

Empowerment by the federal government is also undesirable. NAIC is composed of state insurance commissioners. Those commissioners are accountable to their states and should not be made accountable to federal authority as well, since this would create an irreconcilable conflict of interest. Moreover, given NAIC's organizational structure, congressional delegation of the regulatory authority necessary to establish NAIC as an effective public regulator could raise constitutional questions.

GAO has identified problems in the state-by-state system of insurance regulation. Even though the responsibility for regulating insurance companies rests with each state individually under the state-by-state system, NAIC has attempted to address some of these problems by assisting or, in some cases, overseeing the states as they carry out their activities in attempts to strengthen state-by-state regulation. For example, GAO found that NAIC

-- has improved the credibility of insurers' reported financial information,

-- is attempting to improve capital standards through the promulgation of risk-based capital requirements,

-- is attempting to improve its monitoring systems to better identify troubled companies,

-- has established a peer review process to better ensure that troubled companies are more effectively dealt with, and

-- is providing the states with a variety of automated data bases and tools to facilitate their oversight of companies.

These and other efforts are steps in the right direction, though all of them leave room for further improvement.

NAIC's plan to create a national regulatory system consistent across all the states rests in large part on the success of its program to accredit state insurance departments that satisfy a set of minimum standards for solvency regulation. For several reasons, GAO questions whether NAIC's accreditation program can achieve its goal.

In conclusion, NAIC's efforts to strengthen insurance regulation are laudable. However, NAIC does not have the authority necessary to fulfill its assumed role as a national regulator. As a result, NAIC is unlikely to achieve its stated goal of establishing a national insurance regulatory system. It can neither compel state actions necessary for effective regulation nor, in the long run, can it sustain its reforms.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to provide you with our findings about the role of the National Association of Insurance Commissioners (NAIC) and its capability to create and maintain an effective national system of solvency regulation.[1] Recent financial difficulties involving insurers, as well as other financial institutions, show clearly that effective regulation is crucial to maintaining the safety of financial institutions and their customers' funds. In 1945, Congress enacted the McCarran-Ferguson Act[2] delegating the day-to-day responsibility for insurance regulation to the states but not forfeiting its responsibility for insurance regulation. In our view, the consequences of insolvency, both actual and possible, justify a continuing federal interest in the effectiveness of insurer solvency regulation.

We did fieldwork at NAIC's Kansas City headquarters to evaluate NAIC's activities and operations. We did our work between January and May 1991. I want to emphasize at the outset that we worked closely with NAIC in doing our review, and we met with NAIC twice to discuss our findings and give them an opportunity

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[1]NAIC is a voluntary association of the heads of the insurance departments of the 50 states, the District of Columbia, and 4 U.S. territories. NAIC has two organizational elements: the group of state insurance commissioners and its centralized Support and Services Office (support office) headquartered in Kansas City, Missouri.

[2]15 U.S.C. Sections 1011-1015.

to provide additional information. I also want to emphasize that NAIC was cooperative in our current review. However, we do not have statutory access to state insurance departments or NAIC. This lack of access has on several past occasions limited our ability to assess the effectiveness of state insurance regulation.

MARKET TRENDS AND REGULATORY PROBLEMS

Financial markets and industries have changed dramatically in recent decades. Many of the changes in financial institutions result from changes in information and communication technologies, which have made the world smaller and competition greater within the financial services industry. Geographic boundaries--always loose for insurance companies--have faded, and new products and services have blurred the distinctions between financial markets and institutions. There is no indication that this era of change is over. On the contrary, changes in financial markets and institutions continue.

The need to adapt to the increasingly competitive environment has presented problems for many types of financial institutions--commercial banks, savings and loans, securities firms, and insurers. We see these stresses in the insurance industry in increasing insolvencies among both the property/casualty and life/health insurers. For property/casualty insurers, the

average number of liquidations from 1970 to 1983 was about six per year. However, from 1984 to 1989, the average number of property/casualty liquidations increased to 24 per year, with a high of 36 in 1989. For life/health insurers, the average number of liquidations from 1975 to 1983 was about five per year. However, from 1984 to 1990, the average number of life/health liquidations was about 19 per year, with a high of 43 in 1989.

The strains on the insurance industry have greatly expanded the burden on regulators. The increase in the numbers of failures and their potential consequences for consumers and the economy make effective regulation of the insurance industry more important than ever.

However, in our view, state-by-state solvency regulation has three inherent weaknesses:

(1) States vary widely in the quality of their solvency regulation. There are differences in regulatory workload, such as the number, size, and type of companies domiciled or licensed in a state; the available resources in a state; and each state's "regulatory philosophy."

(2) States do not have consistent solvency laws and regulation, nor do they fully coordinate their efforts despite their interdependence in regulating a national insurance market.

The primary regulator for a multistate insurer--the regulator in its state of domicile--must rely on other states where the insurer operates to voluntarily share information about the company. This does not always occur. Conversely, other states rely on the primary regulator to take prompt corrective action to resolve a troubled or failing insurer. This does not always occur either.

(3) State regulators do not oversee holding companies and foreign reinsurers. In part, these blind spots may have prevented regulators from acting to forestall several large insurer failures.

EFFECTIVE REGULATION MANDATES USE OF AUTHORITIES THAT NAIC DOES NOT POSSESS

State insurance commissioners created NAIC, in part, to help address the problems that differing state-by-state authorities and regulatory tools caused as the states regulated multistate insurers. Since 1987, NAIC has expanded its support staff and computer facilities to provide more services for state regulators. In 1991, the support office has a budgeted staff level of 142 and expenditures of $15.5 million, which is funded mainly by fees paid by insurance companies. Appendix I contains information about NAIC's revenue sources and expenses.

NAIC has recently stated the goal of creating a "national" regulatory system. We do not believe that NAIC can successfully attain that goal.

We have assessed the adequacy of regulation in virtually all financial services sectors--savings and loans, commercial banks, credit unions, the farm credit system, government-sponsored enterprises, securities dealers and markets, futures markets, and insurance companies. Despite the differences among these sectors, we see the need for effective regulation in each and important similarities in the basic characteristics that underlie effective regulation. In our view, to effectively create and maintain a national system of insurance regulation, a regulatory organization would need authority to

-- establish uniform accounting and timely reporting requirements for insurers;

-- establish uniform rules defining safe and sound operation of insurers;

-- establish minimum capital standards commensurate with the risks inherent in an insurer's operations;

-- establish minimum standards for effective solvency regulation by state insurance departments;

-- monitor the supervisory and regulatory functions of state insurance departments;

-- compel state regulators to enforce the rules for safe and sound insurer operations, including the minimum capital requirements, and to take appropriate actions to resolve or close troubled insurers; and

-- levy assessments to cover the costs of oversight and supervision, and maintain sufficient staff and resources to adequately oversee the industry.

Furthermore, like any public regulator, a national insurance regulator would be subject to statutory and constitutional constraints, including appropriate oversight. A public regulator, for example, must often comply with disclosure requirements, restrictions on employee activities, conflict-of-interest laws, and mandatory decision-making procedures such as those contained in federal or state administrative procedures acts. Public regulators are subject to constitutional restrictions--they may not deprive any person of property without due process of law.

We do not believe NAIC can effectively carry out all the functions necessary for effective solvency regulation nor is it subject to the appropriate statutory and constitutional

constraints. Although NAIC can and does establish voluntary standards for insurers and state regulators, the states have conferred no governmental power on NAIC, and it does not have the authority to enforce its standards. In the state-by-state system of solvency regulation, NAIC cannot compel states to accept and implement its standards. Because Congress has allocated authority to regulate the business of insurance to the states, each state has exclusive authority to establish and implement solvency regulation within its jurisdiction. However, each state could legislatively cede some of its authority to NAIC. Even if each state volunteered to do this, NAIC's standing as a regulator would always be weak because its authority would be subject to revocation at any time by each state's legislature. In effect, NAIC would regulate at the pleasure of those it regulated.

Furthermore, because NAIC is a private organization controlled by state insurance commissioners, it does not appear that NAIC should be delegated federal authority to regulate state insurance departments for at least two policy reasons. First, state insurance commissioners are accountable to their states and should not be accountable to federal authority as well, since this would create an irreconcilable conflict of interest. Second, congressional delegation of the regulatory authority necessary to establish NAIC as an effective public regulator could raise constitutional questions.

NAIC IS WORKING TO IMPROVE STATE SOLVENCY REGULATION --BUT IT HAS NO AUTHORITY

The authorities that I enumerated for effective supervision and regulation of the industry should be exercised to accomplish five key objectives. These key regulatory objectives are (1) consistent and timely accounting and reporting, (2) early identification of troubled insurers, (3) timely resolution of troubled companies, (4) effective oversight of holding companies and foreign reinsurers, and (5) uniform state solvency laws and regulations.

The states have primary responsibility for accomplishing each of these regulatory objectives. However, we have identified problems in the state-by-state system in meeting these objectives. In an effort to address these problems, NAIC has acted to assist or oversee the states as they carry out their activities. As I indicated, the ultimate success of NAIC's actions in each of these areas is limited by its lack of authority to compel more effective regulation.

Consistent and Timely Accounting and Reporting

To effectively monitor solvency and identify troubled insurers, regulators need accurate and timely information. In addition, the financial reports that regulators need should be prepared under consistent accounting and reporting rules that result in

the fair presentation of an insurer's true financial condition. Although NAIC is working to address these needs, we have identified a number of areas where improvements are needed.

First, a lack of uniformity in the statutory accounting practices (SAP) of the states may hinder effective monitoring of a multistate insurer's financial condition. Although each state requires most domiciled and licensed insurance companies to use and file the annual financial statement that NAIC developed, individual states may allow accounting practices that differ from those codified in NAIC's practices and procedures manuals. Since a multistate insurer generally prepares its annual statement in accordance with the SAP of its state of domicile, that annual statement filed in other states may not be consistent with or comparable to the SAP of those states. Other states where the insurer is licensed may require the company to refile or file supplements in accordance with their SAP. In this case, the states would be using different financial data to evaluate the same insurer.

In an effort to encourage greater consistency in accounting practices, NAIC plans to revise its accounting manuals to unify existing statutory practices. However, even if NAIC adopts more uniform statutory accounting principles, each state could interpret or modify those accounting principles.

Second, certain requirements of SAP may result in an insurer not fairly reflecting its true financial condition. For example, SAP requires insurers to reduce their surplus by 20 percent of certain reinsurance amounts overdue by more than 90 days. In contrast, Generally Accepted Accounting Principles--used by insurance companies for other-than-regulatory reporting--require an evaluation of the collectability of the entire amount recoverable and could require as much as a 100-percent write-down. This GAAP requirement would result in the insurer's annual statement reflecting the amount of reinsurance ultimately expected to be collected, a better measurement than the arbitrary percentage required by SAP.

Third, false and misleading financial statements have contributed to insurer insolvencies. Many states had been relying on unverified insurer-reported financial data. NAIC now requires both actuarial certification of loss reserves for property/casualty insurers and, beginning this year, annual audits by independent certified public accountants (CPA) as part of its annual financial statement which every state uses. In this instance, NAIC has succeeded in using its authority to prescribe reporting requirements to try to improve the credibility of insurer-reported data. But, problems persist despite NAIC's improvements. For example:

-- The annual independent audit requirement is a definite improvement. But, the basis of the audit opinion still varies from state to state. This is because the (CPA) audit opinion is based on those statutory accounting practices prescribed or permitted by the state where an insurer is headquartered. Attempts by NAIC to unify statutory practices could facilitate comparisons of insurers, but differing state laws or prescriptions would still take precedence over NAIC's accounting guidance.

-- The actuarial certification of loss reserves is not necessarily credible. NAIC allows states the option of accepting certification by insurance company employees. We believe loss reserves should be independently verified and certified.

Fourth, even when insurers correctly report their financial information, regulators are not getting it soon enough to identify troubled insurers. As we have previously reported,[3] annual statements do not give regulators an indication of problems occurring early in a calendar year until between March and May of the following year. That means a lag of between 15 and 18 months from when the problem started and when the annual statement is reviewed. Because a financial entity can fail

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[3]Insurance Regulation: Problems in the State Monitoring of Property/Casualty Insurer Solvency (GAO/GGD-89-129, Sept. 29, 1989).

quickly, we believe quarterly reporting is necessary. NAIC said that, as of February 1991, 21 states required their companies to file quarterly statements, and another 16 states asked insurers to file on a quarterly basis. NAIC cannot require states to adopt quarterly reporting, but it has started to capture quarterly filings that are required by the states. These data are now available on-line to the states and will be used in NAIC's solvency analysis.

Fifth, current capital and surplus requirements, which vary widely from state to state, are not meaningfully related to the risk an insurer accepts. For example, minimum statutory surplus requirements for a life insurer range from $200,000 in Colorado to $2 million in Connecticut. Likewise, minimum statutory surplus requirements for a property/casualty insurer range from $300,000 in the District of Columbia to $2.9 million in New Jersey. NAIC is developing risk-based capital requirements to be determined by the nature and riskiness of a company's assets and insurance business. It plans to incorporate formulas for calculating capital needs into the annual statement. This would have the effect of requiring all companies to report their risk-based capital target as well as their existing capital. NAIC is also working on a model policy for states' consideration to encourage uniform state action against insurers that do not meet the new capital requirements. To be effective, the model would have to be adopted without modification by all states.

Early Identification of Troubled Insurers

Without early identification of troubled companies, state regulators cannot reverse the affairs of troubled companies or act to minimize the damage resulting from insolvency. As we have previously reported, regulators have been relying on delayed and unverified insurer-reported financial data and infrequent field examinations to detect solvency problems. NAIC has a number of initiatives underway to help remedy deficiencies in timely identification of troubled insurers.

Database Services

Since 1988, NAIC has increased its support staff and computer facilities to improve collection and analysis of financial and other data on insurance companies. Through NAIC's telecommunications network, states have on-line access to NAIC's database of annual financial statements. The most recent 6 years of financial data for about 5,200 insurance companies are maintained on-line for regulatory analysis, with tapes available back to 1979. However, NAIC's financial database is only as good as the insurer-reported data, and, as I said, its actions to improve data quality have not been sufficient to ensure that outcome.

NAIC has also developed legal and regulatory databases to help state regulators share information about troubled multistate insurers. This way, states can get a better picture of the complete activities of a troubled multistate insurer and prevent suspicious operations from spreading. Among these databases, NAIC's Regulatory Information Retrieval System gave states on-line access to the names of more than 49,000 insurance companies, agencies, and agents, as of April 1991, that have been subject to some type of formal regulatory or disciplinary action.[4] Its new Special Activities Database, which has been operating since June 1990, is a clearinghouse for information on companies and individuals that may be involved in questionable or fraudulent activities.

NAIC also is developing a national complaint database that will help each state assess policyholder complaints from other states about multistate insurers and agencies. Complaint information, which can give states indications of solvency and other problems, is now maintained only state-by-state.

NAIC's databases are important steps in the right direction, but their ultimate success depends on the quality of insurer-reported financial data and the willingness of state regulators to volunteer information and use the databases.

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[4]Examples of formal regulatory or disciplinary actions include license revocations, fines, and suspensions.

NAIC's Independent Solvency Analysis

State regulators generally focus their resources on insurers domiciled in their state. NAIC independently operates two solvency analysis programs to help states identify potentially troubled multistate insurers operating in their state but domiciled in another state. This is an important service because only a few states routinely provide others with regular updates on financially troubled insurers. Although state regulators are still ultimately responsible for determining an insurer's true financial condition, NAIC's solvency analysis is intended to be an important supplement to the states' overall solvency monitoring.

The first of NAIC's solvency analysis programs--the Insurance Regulatory Information System (IRIS)--is intended to help states focus their examination resources on potentially troubled companies. NAIC also makes preliminary IRIS results available to the public. We have reported our concern that IRIS' effectiveness and usefulness as a regulatory tool is limited by certain deficiencies:[5] (1) it relies on insurer-prepared annual statements that previously were not always independently verified and are subject to significant time lags, (2) its financial ratios have a limited scope and may not identify all

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[5]Insurance Regulation: The Insurance Regulatory Information System Needs Improvement (GAO/GGD-91-20, Nov. 21, 1990).

troubled insurers, (3) it is not equally effective in assessing different types and sizes of insurers, (4) it does not adequately address some important aspects of insurer operations, (5) it does not consider some readily available sources of solvency information, and (6) it is identifying an increasing number of companies, some of which may not warrant immediate regulatory attention.

In 1990, NAIC developed a new computer-based financial analysis system to identify potentially troubled companies requiring state action. The Solvency Surveillance Analysis System appears to address a number of weaknesses we identified with IRIS. However, this new solvency system is only in its second year of operation, so it is too soon to assess how well it will identify potentially troubled companies or whether it will identify them early enough for effective state action.

As part of its 1991 Solvency Agenda, NAIC plans to help the states identify troubled insurers by improving its solvency analysis systems. NAIC also added, in January 1991, a centralized division of financial analysis, which is intended to help states improve their financial analysis capabilities.

Automated Analysis Tools

In addition to NAIC's database and analysis systems to identify troubled insurers, the support office has developed automated tools to help state regulators more efficiently analyze financial statements and examine insurance companies. NAIC also purchased audit software and offered it to state insurance departments at no charge; 35 states had obtained the software by early 1991. Of particular note, NAIC has developed new tools to help states assess reinsurance collectability. Uncollectible reinsurance has contributed to several large property/casualty insurer failures. NAIC now requires insurers to disclose overdue amounts recoverable from reinsurers and has automated these data. State regulators can use NAIC's reinsurance database to quantify overdue reinsurance and identify slow-paying reinsurers. NAIC acknowledges that its reinsurance database is only as good as insurer-reported financial data, and it is working to identify insurers who report incorrect or incomplete information.

Resolving Troubled Companies

Once regulators decide that an insurer is troubled, they must be able and willing to take timely and effective actions to resolve problems that may otherwise result in insurer insolvency. When problems cannot be resolved, regulators must be willing and able

to close failed companies in time to reduce costs to state guaranty funds and protect policyholders.

In a recent report, we analyzed the timing of state regulatory action against financially troubled or insolvent property/casualty insurers.[6] Regulators in 46 states and the District of Columbia reported to us the dates of insolvency for 122 insurers and the dates on which formal regulatory action was initially taken against those insurers. In 71 percent of those cases, the states did not take formal action until after the insurer was already insolvent. We also found that states delayed liquidating insolvent insurers under state rehabilitation.

Delays in regulatory action against financially troubled or failed property/casualty insurers increased costs for state guaranty funds and delayed payment of policyholder claims. In 36 failed insurer cases where financial data were available, the company increased its sales of insurance policies, even after state regulators identified financial trouble. This obviously increases the burden on state guaranty funds. In 47 cases where liquidation was delayed, policyholders with claims did not get paid promptly because claim payments were suspended.

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[6]Insurance Regulation: State Handling of Financially Troubled Property/Casualty Insurers (GAO/GGD-91-92, May 21, 1991).

We found many reasons for regulatory delay in dealing with troubled or insolvent insurers. In addition to relying on inaccurate and untimely data reported by insurers, states also generally lacked legal or regulatory standards for defining a troubled insurer, and vague statutory language made establishing insolvency difficult. Actions that are needed to correct these problems include developing a single uniform standard for determining if an insurer is financially troubled, requirements that certain actions be taken when specific hazardous conditions are present, and a single uniform legal definition of insolvency based on loss reserves and capital adequacy. Such action would improve protection of policyholders and state guaranty funds.

In 1989, NAIC created a new multistate peer review committee--the Potentially Troubled Companies Working Group--to track how states are handling problem companies. The group looks at the companies that NAIC's independent financial analysis identifies as potentially troubled and selects certain companies for special attention. It requests states to respond in writing to its questions about those companies. State commissioners also are asked to appear before the NAIC commissioner committee that oversees the working group to discuss how they are handling potentially troubled insurers. According to NAIC, regulators are to, at a minimum,

-- demonstrate an understanding of both the nature and extent of the company's problem;

-- establish that the state has a sufficient plan of action to assist in correcting or stabilizing the company or that the state has an orderly process to withdraw the company from the marketplace;

-- establish that the state has the laws, regulations, and personnel to effectively carry out the necessary regulatory actions; and

-- establish that the state has effectively communicated its concerns to other regulators in states with policyholders who are at risk.

NAIC follows up on potentially troubled insurers and, if necessary, may form a special group of state regulators to oversee regulatory activities for a troubled company. According to NAIC, peer review helps to ensure that individual states are promptly addressing problems and keeping other states informed about troubled multistate insurers.

We do not know whether this peer review process, which is in only its second year, will prompt individual states to take more timely action to deal with troubled insurers or the extent to

which it will enhance coordination of supervision of troubled multistate insurers. Whatever the influence of peer pressure, supervisory actions to address problems of a troubled insurer remain the primary responsibility of the domiciliary state regulator, and the coordination of such actions involving multistate insurers is a matter of negotiation among all involved states. NAIC has no enforcement power to compel a state to take action against a troubled insurer.

Oversight of Holding Companies And Foreign Reinsurers

To effectively monitor insurer solvency, regulators must be able to routinely oversee insurance holding companies. Interaffiliate transactions are common in the insurance industry and are not necessarily detrimental. However, such transactions are subject to manipulation and may be used to obscure an insurer's true financial condition. Abusive interaffiliate transactions caused the Baldwin-United failure--the largest life insurance failure in history.

States do not regulate insurance holding companies and cannot regulate the noninsurance affiliates or subsidiaries of an insurance company. Consolidated statements for insurers and affiliates might help states evaluate the overall financial condition of a holding company, but, according to NAIC, only 13 states require some form of consolidated reporting. NAIC has

adopted model laws on holding companies to emphasize the need to regulate these transactions and encourage uniform state regulation. However, not all states have adopted NAIC's current model laws.

As we previously reported,[7] states have no authority to monitor the financial condition of reinsurers in other countries that do business with U.S. insurers. To effectively monitor insurer solvency, regulators need this authority. Foreign reinsurers provide more than one-third of the reinsurance written in the United States. While many foreign reinsurers are responsible and reliable institutions, some foreign reinsurers have failed to pay claims. Uncollectible reinsurance has contributed to several large insurer failures.

NAIC has tried to help state regulators monitor foreign reinsurers operating in the United States by providing to them a database of reinsurance activity reported by U.S. insurers. State regulators can now quantify amounts reported as ceded to any reinsurer worldwide and totals ceded by country. However, NAIC has made little progress in helping states evaluate the financial condition of foreign reinsurers. While NAIC

[7]Insurance Regulation: State Reinsurance Oversight Increased, but Problems Remain (GAO/GGD-90-82, May 4, 1990).

maintains a so-called white list of acceptable foreign insurers,[8] it specifically excludes foreign reinsurers. NAIC cannot require foreign companies to submit financial reports. Thus, its authority to evaluate either foreign insurers or reinsurers is no greater than a private rating organization's. NAIC believes that federal legislation is necessary to empower it to require foreign insurers and reinsurers to submit to monitoring as a condition for doing business in the United States and to require the states to use NAIC's listing.

State Solvency Laws and Regulations Are Not Uniform

Without uniformity in solvency laws and regulations, the state-by-state regulatory system is only as strong as the weakest link. Because insurers operate in many states, lack of uniformity in state solvency regulation provides opportunities for unsafe and unsound operations while it complicates regulatory detection of those activities.

Over the years, NAIC has developed and proposed for states' consideration about 200 model laws and regulations designed to foster state acceptance of the legal and regulatory authorities necessary to effectively regulate insurance. However, NAIC has

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[8]NAIC's Non-Admitted Insurer Information Office maintains a quarterly listing of acceptable foreign insurers--those that have capital and surplus of at least $15 million, maintain a U.S. trust fund of not less than $2.5 million, and have a reputation of character, trustworthiness, and integrity.

no authority to require states to adopt or implement its model policies. Before this year, NAIC had only limited success in getting states to adopt its model laws and regulations. Moreover, states that do adopt model laws can--and do--modify them to fit their situations. For example, every state has a property/casualty guaranty fund to pay policyholders of failed insurers. Although most guaranty funds are patterned after the NAIC model, significant differences between state laws result in some funds offering less protection than others. This undermines NAIC's efforts to achieve uniformity. (Appendix II compares the provisions of property/casualty guaranty funds in each state.) Another impediment to uniformity is the uneven adoption by states of NAIC amendments to its model laws and regulations.

Frustrated by the difficulty of getting states to enact model polices and provide sufficient regulatory resources, NAIC adopted a set of financial regulation standards for state insurance departments in June 1989. These standards identified 16 model laws and regulations, as well as various regulatory, personnel, and organizational practices and procedures, that NAIC believes are the minimum for effective solvency regulation. Appendix III describes model law development and presents statistics on state adoption of those NAIC models.

Since January 1991, the National Conference of State Legislatures and the National Conference of Insurance Legislators have called on the states to comply with NAIC's standards. Likewise, the National Governors' Association has endorsed NAIC's efforts.

NAIC's Accreditation Program

In June 1990, NAIC adopted an accreditation program to encourage state insurance departments to comply with its new financial regulation standards. According to NAIC, its new accreditation program will have the effect of establishing a national system of solvency regulation consistent across all states.

However, we question whether NAIC's accreditation program can achieve this goal. First, even if the standards were implemented by all of the states, they would provide little more than an appearance of uniformity. The standards, for the most part, are general, and their implementation can vary widely. Second, the accreditation review process has significant shortcomings that cast doubt upon the credibility of NAIC's program. Third, even if the first two problems were solved, NAIC remains in the position of attempting to regulate the state regulators with no authority to compel their compliance.

Overview of the Accreditation Program: To become accredited, a state must submit to an independent review of its

compliance with NAIC's financial regulation standards. An accreditation team[9] is to review laws and regulations, past insurance company examination reports, and organizational and personnel policies; interview key department personnel regarding how legal provisions and regulatory practices are implemented; and assess the department's levels of reporting and supervisory review. The team is to report its recommendation as to whether or not a state meets the standards to the NAIC Committee on Financial Regulation Standards and Accreditation.

This committee of state insurance commissioners decides whether or not a state becomes accredited. To avoid a direct conflict of interest, the commissioner from a state applying for accreditation cannot vote on that state's accreditation. Nevertheless, since each state ultimately will undergo an accreditation review, a commissioner voting to deny accreditation to another state may be subject to retaliation. Likewise, commissioners could engage in "backscratching," trading an affirmative accreditation vote for another state to obtain an affirmative vote for their own state accreditation. While we have no evidence that this has occurred, we note that the committee process is not sufficiently devoid of potential conflicts of interest to preclude the opportunity.

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[9]A review team member must be knowledgeable about insurance and its regulation and should not currently be associated with the state insurance department under review including representing insurers in matters before that state.

States that satisfy NAIC's financial regulation standards will be publicly recognized by NAIC as "accredited" while departments not in compliance will receive guidance on how to comply. Accreditation is for a 5-year period; to be reaccredited, a state must undergo an independent review. NAIC is developing procedures for maintaining accreditation during the 5-year period and decertifying states no longer in compliance.

NAIC plans to have accredited states penalize insurers domiciled in states that do not become accredited. Among the planned restrictions, beginning in January 1994, an accredited state would not license an insurer domiciled in an unaccredited state unless the insurer agrees to submit to the accredited state's solvency laws and regulations and associated oversight. Whereas the home state usually has primary responsibility for solvency monitoring and regulation, this penalty would subject a multistate insurer domiciled in an unaccredited state to regulation in every accredited state in which it is licensed. Given the varying state solvency laws and regulations, NAIC's penalties would be onerous for insurers domiciled in unaccredited states. If the accredited states carry out the penalties, according to NAIC, this would give insurers the incentive to lobby for the increased authority and resources their home state needs for accreditation.

In December 1990, NAIC accredited Florida and New York, the first two states to undergo review. Illinois and South Carolina were accredited by NAIC in June 1991. At least eight other states have applied for accreditation as of July 1991.

Standards May Not Achieve Uniformity And May be Inadequate: NAIC's standards may not achieve uniformity since they do not set specific criteria or practices for the states to meet. This is why even universal adoption of the standards would provide little more than the appearance of uniformity. For example, NAIC's current capital and surplus standard requires, in part, that a state have a law that establishes minimum capital and surplus requirements. However, the standard does not specify what those minimum requirements should be. NAIC has said that this standard will be replaced when NAIC completes its new risk-based capital requirements.

Another example is the standard for investment regulation. NAIC's standard is that a state should require insurance companies to have a diversified investment portfolio, but the term "diversified" is not defined. Other important terms--"sufficient staff" and "competitively based" pay, for example--in the standards are similarly vague.

Furthermore, we believe that some of the standards, in addition to being nonspecific, are inadequate to address regulatory

problems that we have identified. For example, the model regulation underlying NAIC's standard for corrective action against troubled insurers is qualitative even when dealing with quantifiable conditions. NAIC's standard does not set a uniform measure for determining if an insurer is financially troubled or prescribe regulatory actions to be taken when specific hazardous conditions are present. As previously mentioned, lack of such regulatory guidance causes delay in states' handling of troubled insurers.

NAIC's Accreditation Review Process Has Serious Shortcomings: NAIC's accreditation review process suffers from two serious shortcomings. First, because the standards are not specific, there are no criteria for the accreditation teams to use in assessing compliance with the financial regulation standards. Second, the lack of documentation and procedural requirements for the team review has, to date, made it impossible to independently decide whether a team's work was sufficient to justify a recommendation for or against accreditation.

To evaluate compliance with NAIC's standards, each accreditation team has to develop its own criteria for what constitutes acceptable compliance. To define terms and set more specific criteria for its standards, NAIC plans to have future review teams keep records of the criteria they use in assessing compliance with NAIC's standards. They will document the

criteria in their reports to the NAIC accreditation committee. NAIC said all criteria will be shared with the states in an effort to achieve greater consistency in the process and so that individual states can better prepare for accreditation.

Due to the lack of documentation, we do not know the basis for the findings of the accreditation team in Florida and New York. The review reports for the two states--each about one-half page in length--recommended that the state insurance department be accredited "based upon this evaluation effort and the knowledge and experience of the evaluation team." While the four-page report for the Illinois accreditation better documented what work the review team did, the report still did not document the basis for the team's findings or recommendations. Without such documentation or elaboration, it is impossible to independently verify that the team's analysis was sufficient to support its recommendation. NAIC's accreditation committee required the Illinois review team to submit an additional summary of its findings to support the team's conclusions that the state complied with each standard.

Based on lessons learned in Florida and New York, NAIC developed a more detailed work plan for use in subsequent accreditation reviews. The expanded work plan is a good starting point, but it will still be necessary to develop more detailed procedures and documentation requirements to ensure consistency between review

teams and support for findings in the future. We base this conclusion on our observations of an accreditation review team planning session in March 1991 and the team's visit to the Illinois Insurance Department in April 1991. We question whether NAIC's work plan for the Illinois review was sufficient to ensure accreditation reviews that are consistent and sufficiently documented. NAIC's only quality control over the team's analysis has been to have an observer from the support office on each review.

A final problem with the accreditation review work plan is that coverage of work does not seem to have been sufficient to assess how well a state implements NAIC's standards. We question, for example, how the accreditation team assessed implementation of Florida's regulations given that several key provisions were adopted through emergency rule-making only weeks before the review. Although the standards called for the review team we observed to assess whether Illinois had implemented NAIC's guidance on handling troubled insurers, the team did not. Team members said that they assumed Illinois had followed NAIC's procedures because Illinois helped write the handbook.

CONCLUSIONS

Although insurance is a national market, the state-by-state system of insurance solvency regulation is characterized by varying regulatory capacities and a lack of uniformity.

NAIC has taken a number of steps toward strengthening the state-by-state regulatory system and addressing a variety of problems. It has been successful in using its authority to prescribe reporting requirements to achieve uniformity in some aspects of state solvency regulation. NAIC has not been as successful with its model laws, which must be adopted by each state.

NAIC is trying to establish a national system of effective solvency regulation through its accreditation program. In effect, NAIC has assumed the role of a regulator of state insurance regulators. However, we do not believe that state adoption of NAIC's current standards will achieve a consistent and effective system of solvency regulation. The underlying standards for accreditation are often undemanding and, in some cases, inadequate.

Even if NAIC devised sufficiently stringent standards for effective solvency regulation, however, we do not believe that NAIC can surmount the fundamental barriers to its long-term effectiveness as a regulator. Most importantly, NAIC lacks authority to enforce its standards. NAIC is dependent on consensus--indeed unanimity--among state insurance commissioners and legislatures to enact and implement its policy recommendations in a manner that achieves consistency in state-by-state regulation. Progress toward such consensus and unanimity appears to be occurring presently under the glare of

intensified public scrutiny of the insurance industry and its regulators. Given NAIC's historical lack of success in securing state adoption of its model policies, it is highly questionable whether such progress will be sustained over the long run as interest in the industry's condition wanes.

NAIC does not have the authority necessary to compel state action or to sustain its reforms. We do not believe it can effectively be given such authority, at least on a lasting basis, by either the states or the federal government. The main road to effective regulation of the insurance industry does not pass through NAIC.

This completes my prepared statement. We would be pleased to respond to your questions.

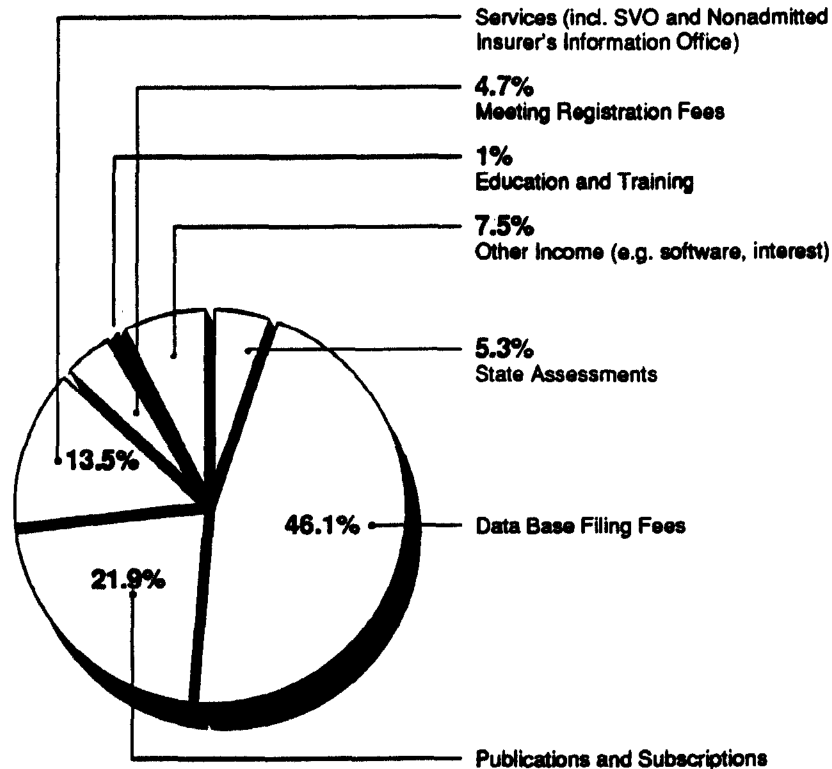
NAIC'S FUNDING AND EXPENSES

NAIC is a voluntary association of the heads of the insurance departments of the 50 states, the District of Columbia, and 4 U.S. territories. NAIC has two organizational elements: the group of state insurance commissioners and its centralized Support and Services Office (support office) headquartered in Kansas City, MO. This appendix presents the funding sources and the expenses for NAIC's activities and operations.

NAIC's Revenue Sources

NAIC estimates that its total 1991 revenue will be about $16.2 million. Figure I.1 illustrates NAIC's revenue sources. While NAIC serves state regulators, assessments on the states on the basis of the premium volume of their domestic insurers represent about 5 percent of NAIC's revenue. Other than education and training, which represent 1 percent of NAIC's revenues, NAIC's services and publications are available to the states at no cost.

Figure I.1: NAIC 1991 Revenue Sources



Total 1991 budget revenue $16,155,600

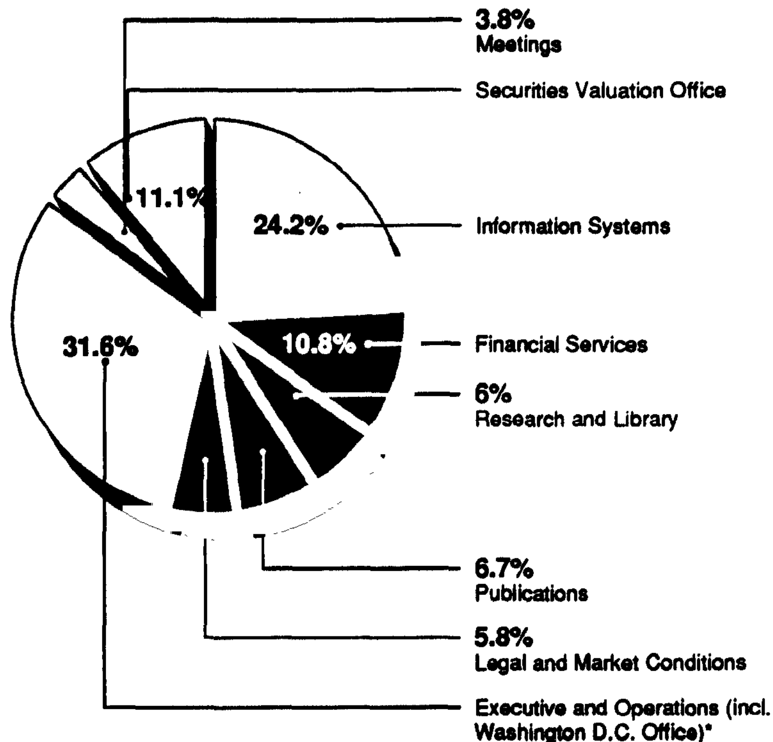
Source: NAIC 1991 Budget

NAIC relies on the insurance industry for most of its revenue. Database filing fees--which represent 46 percent of NAIC's revenue--are mandatory fees on insurance companies that are required by their states to file with NAIC. The insurance industry also purchases NAIC publications and the services of NAIC's Securities Valuation Office (SVO) and the Nonadmitted Insurers Information Office. Finally, only industry representatives pay to attend NAIC's meetings.

NAIC's Expenses

Figure I.2 shows NAIC's proposed expenses for 1991. Nearly one-third of its $15.5 million expense budget is spent on its executive office and operations to support the NAIC committee system. This also includes overhead costs, such as rent and equipment depreciation, for the entire support office. The other major expenses in 1991 are NAIC's information systems ($3.7 million), Securities Valuation Office ($1.7 million), and financial services ($1.7 million).

Figure I.2: NAIC 1991 Proposed Expenses



* Includes rent ($836,676) and depreciation ($1,216,549)

Total 1991 budget expenses $15,492,562

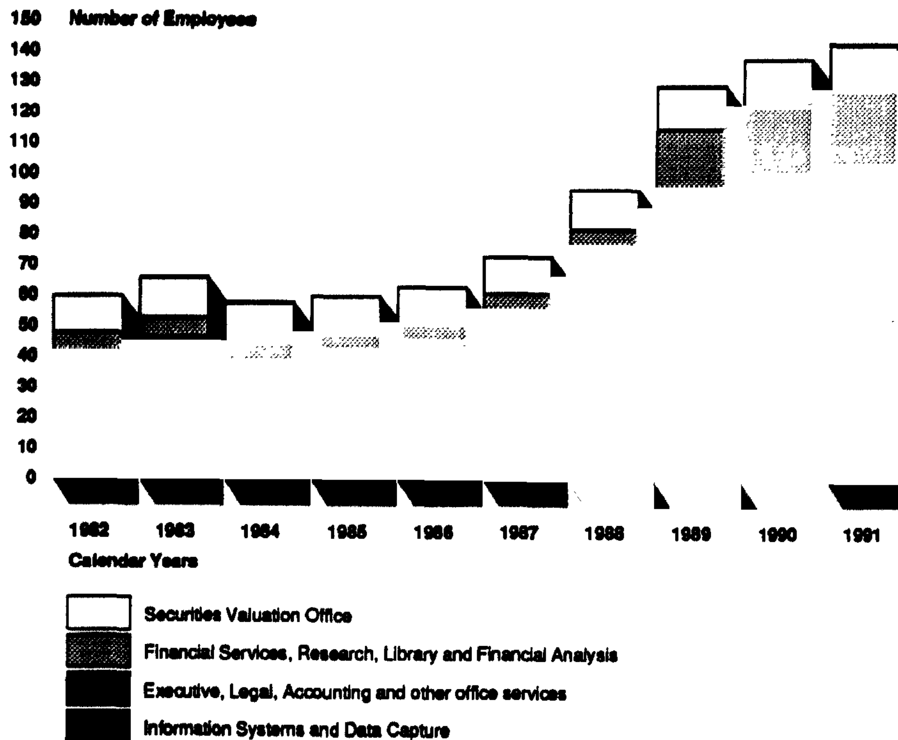
Source: NAIC 1991 Budget

NAIC's Staffing Growth

Since 1987, NAIC's support office has grown rapidly. NAIC's budget has increased over two and a half times, from $5.9 million in 1987 to $15.5 million in 1991. Figure I.3 shows the growth in employment within various departments of NAIC's support office. The number of employees has about doubled from 72 in 1987 to 142 in 1991. NAIC's employment growth reflects its efforts to provide more service to state regulators.

Much of this staffing growth occurred in the information systems department. NAIC operates a $4.5 million computer system and telecommunications network for states to share information and have on-line access to NAIC's financial, legal, and regulatory databases. Computer support staff grew from 17 persons in 1987 to 51 persons in 1991.

Figure I.3: NAIC Staffing by Department (1982-1991)



Source: NAIC

STATE-BY-STATE COMPARISON OF PROPERTY-CASUALTY GUARANTEE FUND PROVISIONS

The National Association of Insurance Commissioners developed a Property and Liability Insurance Guaranty Association Model Act in 1969. Provisions of the Model Act include:

— Lines Covered: all direct lines of insurance except life, annuity, health, disability, mortgage guaranty, financial guaranty, government guaranty, fidelity, surety, credit, warranty and service contracts, ocean marine and title insurance. There is no coverage of insurance for any transaction which involves the transfer of investment or credit risk unaccompanied by a transfer of insurance risk.

— Claim Limits: the maximum amount paid for any claim is $300,000, with the exception of unlimited coverage for workers' compensation.

— Maximum Annual Assessment: insurers are assessed no more than 2 percent of their in-state insurance revenue annually.

— Unearned Premium Coverage: policyholders should be paid for insurance coverage that the policyholder has purchased but not received because the company failed.

— Recoupment Provision: recommendation that insurance companies recover assessments through increasing rates.

Fourteen property-casualty guaranty fund statutes meet or exceed all five of these NAIC standards. The remaining 37 states follow some but not all of these standards. Most differences are in claim limits and maximum annual assessments. A minimum of twelve states have lower claim limits than the NAIC standard, and a minimum of 17 assess insurers at a lower rate than prescribed. Fewer differences exist in the types of insurance covered. For example, only six states offer less coverage than the NAIC standard, and only two states do not cover unearned premiums. Table II.1 compares the property-casualty guaranty fund statutes with selected provisions of the Model Act.

Table II.1: Property-Casualty Guaranty Fund Provisions

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
Alabama	NAIC standard coverage	$150,000 per claim and unlimited workers' compensation	1.0%	Yes	Premium tax offset
Alaska	NAIC standard coverage plus ocean marine	$500,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase

APPENDIX II

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
Arizona	NAIC standard coverage	$100,000 per claim, workers' compensation covered through other provision	1.0%	Yes	Premium tax offset
Arkansas	NAIC standard coverage	$300,000 per claim including workers' compensation claims	2.0%	Yes	Premium tax offset
California	NAIC standard coverage	$500,000 per claim and unlimited workers' compensation	1.0%	Yes	Policy surcharge
Colorado	NAIC standard coverage	$100,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase
Connecticut	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
Delaware	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Premium tax offset
District of Columbia	NAIC standard coverage plus surety and fidelity, credit, and ocean marine insurance	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
Florida	NAIC standard coverage except excludes wet marine	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Premium tax offset (credit against income tax for domestics only)
Georgia	NAIC standard coverage	$100,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
Hawaii	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Policy surcharge
Idaho	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase
Illinois	NAIC standard coverage plus title and credit insurance	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	None
Indiana	NAIC standard coverage except excludes general damages	$100,000 per claim and $300,000 per occurrence. Both limits apply to workers' compensation claims	1.0%	Yes	Premium tax offset
Iowa	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
Kansas	NAIC standard coverage plus surety and fidelity and ocean marine insurance	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Premium tax offset
Kentucky	NAIC standard coverage plus surety and fidelity insurance	$100,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase
Louisiana	NAIC standard coverage	$150,000 per claim and $300,000 per occurrence and unlimited workers' compensation	2.0%	Yes	Premium tax offset
Maine	NAIC standard coverage plus surety and fidelity and some marine insurance	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase

APPENDIX II

APPENDIX II

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
Maryland	NAIC standard coverage plus surety and fidelity, title, credit, and ocean marine insurance	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
Massachusetts	NAIC standard coverage	$300,000 per claim including workers' compensation claims	2.0%	Yes	Rate increase
Michigan	NAIC standard coverage plus surety and fidelity, title, credit, mortgage guaranty, and ocean marine insurance	1/20 of 1 percent of aggregate premiums written by member insurers during the preceding year and unlimited workers' compensation	1.0%	Yes	Rate increase
Minnesota	NAIC standard coverage plus surety and fidelity insurance	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Policy surcharge
Mississippi	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase
Missouri	NAIC standard coverage except excludes general damages	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	Premium tax offset
Montana	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
Nebraska	NAIC standard coverage except excludes general damages	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	Premium tax offset
Nevada	NAIC standard coverage plus credit insurance	$300,000 per claim including workers' compensation claims	2.0%	Yes	Premium tax offset

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
New Hampshire	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
New Jersey	NAIC standard coverage	$300,000 per claim, workers' compensation covered through other provision	2.0%	Yes	Policy surcharge
New Mexico	NAIC standard coverage	$100,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
New York	NAIC standard coverage plus surety and fidelity, and ocean marine insurance	$1 million per claim including workers' compensation	2.0%	Yes	Rate increase
North Carolina	NAIC standard coverage	$300,000 per claim, workers' compensation covered through other provision	2.0%	Yes	Rate increase
North Dakota	NAIC standard coverage	$300,000 per claim including workers' compensation claims	2.0%	Yes	Rate increase
Ohio	NAIC standard coverage	$300,000 per claim including workers' compensation claims	1.5%	Yes	Rate increase
Oklahoma	NAIC standard coverage	$150,000 per claim and unlimited workers' compensation	The lesser of 2 percent of net premiums or one percent of surplus	Yes	Rate increase
Oregon	NAIC standard coverage except excludes transportation	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Premium tax offset

APPENDIX II

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
Pennsylvania	NAIC standard coverage	$300,000 per claim, workers' compensation covered through other provision	2.0%	Yes	Rate increase
Rhode Island	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
South Carolina	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase
South Dakota	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase
Tennessee	NAIC standard coverage except excludes general damages	$100,000 per claim and unlimited workers' compensation	1.0%	Yes	Premium tax offset
Texas	NAIC standard coverage	$100,000 per claim and unlimited workers' compensation	2.0%	Yes	Premium tax offset
Utah	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	No	Premium tax offset
Vermont	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Rate increase
Virginia	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	Yes	Premium tax offset

APPENDIX II

State	Lines of insurance covered[a]	Claim limits	Maximum annual assessments	Coverage includes unearned premiums	Recoupment provisions
Washington	NAIC standard coverage	$300,000 per claim, workers' compensation covered through other provision	2.0%	Yes	Premium tax offset
West Virginia	NAIC standard coverage	$300,000 per claim, workers' compensation covered through other provision	2.0%	Yes	Rate increase
Wisconsin	NAIC standard coverage	$300,000 per claim and unlimited workers' compensation	2.0%	No	Premium tax offset or rate increase
Wyoming	NAIC standard coverage	$150,000 per claim and unlimited workers' compensation	1.0%	Yes	Rate increase

[a] State statutes vary as to which guaranty fund (i.e., property-casualty or life and health) provides coverage for accident, health, and disability insurance written by property-casualty companies. Nonetheless, these lines are covered in every state by one of the funds, except for Colorado, Louisiana, New Jersey, the District of Columbia and New York.

Source: National Conference on Insurance Guaranty Funds; updated by GAO, April 1990.

APPENDIX II

ADOPTION OF KEY NAIC MODEL LAWS AND REGULATIONS

Historically, one of NAIC's principal functions has been to develop model laws and regulations for the states' consideration. These models are designed to improve state insurance regulation and promote uniformity among the states.[1]

Even though NAIC's models represent a consensus of state insurance commissioners on the minimum requirements for effective regulation, the record of their adoption by the states has been mediocre to poor. This is because NAIC can only recommend policies and encourage state adoption. NAIC has no authority to compel states to adopt and implement models which it considers essential for effective solvency regulation. Because states have not universally adopted the models, the state-by-state system of solvency regulation lacks uniformity.

HOW NAIC MODELS ARE DEVELOPED

When NAIC recognizes a regulatory issue needing study or action, it forwards the issue to a group of state regulators. The group generally researches the issue and may hold hearings and request input from industry advisory groups. When the NAIC group believes it has sufficient information, the group may draft and propose a model law or regulation to address the issue. The draft is then discussed and reviewed within NAIC. NAIC can elect to expose the draft model for comment by interested parties. The draft is eventually submitted to NAIC's Executive Committee of officers for approval. If approved, the draft is submitted to all state commissioners for consideration. Models are adopted or rejected by the state insurance commissioners through a majority vote during a plenary session at an NAIC national meeting.

As of April 1991, NAIC had adopted about 200 model acts and regulations for the states' consideration. In addition to solvency-related matters, NAIC models address other regulatory issues, including rate regulation and consumer protection.

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[1]For convenience, our discussion refers to adoption of model laws and regulations by states. In fact, the jurisdications include the 50 states and the District of Columbia for a total of 51 jurisdictions.

KEY NAIC MODELS HAVE NOT BEEN ADOPTED

Through its financial regulation standards adopted in June 1989, NAIC has identified the legal and regulatory authorities which it considers, at a minimum, to be essential for effective solvency regulation. Among other things, the standards include those model laws and regulations which a state insurance department should have to be accredited by NAIC. According to NAIC, its accreditation program has served as a catalyst to drive the adoption of a minimum set of solvency laws and regulations by the states. NAIC has identified 38 states which as of April 1991, have legislation or regulation pending for adoption.

NAIC must rely on state insurance commissioners to introduce the models in their various state legislatures and work for their passage. Individual states, in turn, may modify NAIC models depending on local needs and circumstances.

Using NAIC's Model Laws, Regulations and Guidelines publication service, we tabulated states's adoption of 14 model laws and regulations referenced in NAIC's financial regulation standards. Table III.1 lists 14 model laws and regulations and presents aggregate statistics on the states' adoption of these models as of April 1991.[2] Table III.2 shows the numbers of states which have changes to current legislation or regulation pending and of states which had new legislation or regulation pending as of April 1991, according to NAIC. Table III.3 presents each state's record for adopting the NAIC models.

As these figures show, adoption of NAIC models varies widely. For example, only two of the four NAIC models adopted before 1980--the Standard Valuation Law and the Insurance Holding Company System Regulatory Act--have been substantially enacted in all states. NAIC's Insurers Rehabilitation and Liquidation Act, or legislation that NAIC identified as substantially similar, has been enacted in 24 states, while 27 other states have legislation or regulations related to the subject but not the same or substantially similar to NAIC's model.

While the original insurance holding company model was enacted in virtually every state, most states have not adopted key provisions that NAIC added in 1984 to control abusive

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[2]The figures do not include two NAIC model laws for state guaranty funds. Appendix II compares state provisions for property/casualty guaranty funds.

interaffiliate transactions.[3] In this regard, only seven states adopted expanded authority to issue cease and desist orders and to impose civil penalties, while only six have added a provision allowing a receiver to recover funds from an affiliate. Additionally, NAIC's model regulation to supplement its holding company model act still has not been adopted in nine states.

Of the models proposed by NAIC since 1980, only the Model Risk Retention Act has been adopted in more than half of the states. In contrast, the Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Condition has been adopted by only four states since its adoption in 1985.

NAIC recommended independent annual audits by certified public accountants in 1980. However, by the end of the 1980s, only 15 states had adopted this requirement. NAIC effectively abandoned the model law process as a means to get states to require this important regulatory tool. Instead, NAIC used its authority to prescribe annual statement reporting to require independent annual audits for insurers. This requirement now applies to all states.

For new model laws, proposed after NAIC promulgated its original financial regulation standards in June 1989, states have two years to comply. For example, the Managing General Agents Act and the Reinsurance Intermediary Model Act were added to NAIC's standards in 1990, so the states have until 1992 to comply.

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[3]The 1984 amendments to the insurance holding company act were in response to the Baldwin-United Life insurer failure.

Table III.1: Summary of States' Adoption of NAIC Models Related to Accreditation

NAIC Model	Date Model Adopted by NAIC	Number of States With: Model/ Similar Legislation or Regulation	Related Legislation or Regulation	No Current Legislation or Regulation
Examination Authority (1)	1991	1	50	0
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition	1985	4	4	43
Holding Company Act	1969	49	2	0
Holding Company Regulation	1971	33	9	9
Standard Valuation Law	1943	51	0	0
Credit for Reinsurance Act	1984	19	28	4
Regulation for Life Reinsurance Agreements	1986	7	1	43
CPA Audit Regulation	1980	15	8	28
Rehabilitation and Liquidation Model Act	1978	24	27	0
IRIS Model Act	1985	20	9	22
Risk Retention Act	1983	40	7	4
Business Transacted w/Producer Controlled P/C Insurer Act (1)	1988	2	0	49
Managing General Agent Act (1)	1989	12	7	32
Reinsurance Intermediaries Act (1)	1990	3	1	47

(1) States Have Until 1992 to Adopt

(Information as of April 1991)

Table III.2: Summary of States' With Legislation or Regulations Pending Related to NAIC Accreditation Models

NAIC Model	Date Model Adopted by NAIC	States With: Changes to Legislation or Regulation Pending	States With: Initial Legislation or Regulation Pending
Examination Authority (1)	1991	6	0
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition	1985	0	4
Holding Company Act	1969	16	0
Holding Company Regulation	1971	0	0
Standard Valuation Law	1943	4	0
Credit for Reinsurance Act	1984	12	1
Regulation for Life Reinsurance Agreements	1986	0	1
CPA Audit Regulation	1980	4	5
Rehabilitation and Liquidation Model Act	1978	11	0
IRIS Model Act	1985	3	4
Risk Retention Act	1983	3	1
Business Transacted w/Producer Controlled P/C Insurer Act (1)	1988	0	7
Managing General Agent Act (1)	1989	5	10
Reinsurance Intermediaries Act (1)	1990	2	9

(1) States Have Until 1992 to Adopt

(Information as of April 1991)

Table III.3: States' Adoption of NAIC Models Related to Accreditation

NAIC MODEL	STATE											
	AK	AL	AR	AZ	CA	CO	CT	DE	DC	FL	GA	HI
Examination Authority (1)	R	R	M/R	R	R	R	R	R	R	R	R	R
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition												
Holding Company Act	M	M	M	M/P	M	M	M	M	M	M/R	M	M
Holding Company Regulation	M	M	M	M	M	M	R	M	M		M	
Standard Valuation Law	M	M	M	M	M	M	M/P	M	M	M/P	M	M
Credit for Reinsurance Act	R	M	M/R	R/P	R	R	M	M	R	R	M/R	R
Regulation for Life Reinsurance Agreements		M										
CPA Audit Regulation					R	M	R/P	R		R/P		P
Rehabilitation and Liquidation Model Act	M	R	R	R/P	R	R	M	R	R	R/P	M/R	M
IRIS Model Act	R		M/R	M/P		P				R	M	M
Risk Retention Act	R		M	M	M	R/P	M	R		M	M	M
Business Transacted w/Producer Controlled P/C Insurer Act (1)				P							M	
Managing General Agent Act (1)	R			R/P			P			M	M	
Reinsurance Intermediaries Act (1)				P	P						M	

LEGEND
M:Enacted Model/Similar Legislation
R:Enacted Related Legislation/Regulation
P:Pending Legislation/Regulation
(1)States Have Until 1992 to Adopt
(Information as of April 1991)

Table III.3: States' Adoption of NAIC Models Related to Accreditation

NAIC MODEL	STATE											
	IA	ID	IL	IN	KS	KY	LA	MA	MD	ME	MI	MN
Examination Authority (1)	R	R	R	R/P	R/P	R	R	R	R	R	R	R
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition	M		R		R							P
Holding Company Act	M/P	M	M	M/P	M/P	M	M	M	M	M	M	M/P
Holding Company Regulation	M	M	M	M	M		R	M	M	M	R	M
Standard Valuation Law	M	M	M	M	M	M	M	M	M	M	M	M
Credit for Reinsurance Act	P	R/P	R	R	R	M	R	R	R	M/P		R/P
Regulation for Life Reinsurance Agreements	M			R								
CPA Audit Regulation			M	M/R	M		M	M	R	R	R	M
Rehabilitation and Liquidation Model Act	M	M	R	M	R/P	M	R	R/P	R/P	M	M	M
IRIS Model Act	R	P	M	R	R	M				R		R
Risk Retention Act	M	M	M	M	M	M	M	P	M	M	M	M
Business Transacted w/Producer Controlled P/C Insurer Act (1)	P								P			
Managing General Agent Act (1)	R/P	P	M	P	M		M		P		M	P
Reinsurance Intermediaries Act (1)	P			P								

LEGEND
M:Enacted Model/Similar Legislation
R:Enacted Related Legislation/Regulation
P:Pending Legislation/Regulation
(1)States Have Until 1992 to Adopt
(Information as of April 1991)

Table III.3: States' Adoption of NAIC Models Related to Accreditation

NAIC MODEL	STATE											
	MO	MS	MT	NC	ND	NE	NH	NJ	NM	NV	NY	OH
Examination Authority (1)	R	R	R	R/P	R	R	R	R	R	R	R	R/P
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition	P			P		M						P
Holding Company Act	M/P	M	M	M/P	M/P	M	M/P	M	M	M	R/P	M/P
Holding Company Regulation	M			R	M	M	M		M	R	R	M
Standard Valuation Law	M	M	M	M	M	M	M	M	M	M	M	M
Credit for Reinsurance Act	M/P	R/P	M	M/P	R/P	M	M/P		R	R	R	R/P
Regulation for Life Reinsurance Agreements				P		M					M	
CPA Audit Regulation	P	P		M/R/P		M		M			R	M
Rehabilitation and Liquidation Model Act	M/R	R/P	M	M/P	R/P	M	M/P	R	R	R	R	M
IRIS Model Act	M			M/P	M	M/P	M		R			M
Risk Retention Act	M/P	M	M	M	M	M	M	M	M	M	M	M
Business Transacted w/Producer Controlled P/C Insurer Act (1)	P			P	P							P
Managing General Agent Act (1)	M	P		R/P	M/P	M	P			M	R	P
Reinsurance Intermediaries Act (1)	M/P			P	M/P		P				R	

LEGEND
M:Enacted Model/Similar Legislation
R:Enacted Related Legislation/Regulation
P:Pending Legislation/Regulation
(1)States Have Until 1992 to Adopt
(Information as of April 1991)

Table III.3: States' Adoption of NAIC Models Related to Accreditation

NAIC MODEL	STATE											
	OK	OR	PA	RI	SC	SD	TN	TX	UT	VA	VT	WA
Examination Authority (1)	R/P	R	R	R	R	R	R	R	R	R	R	R
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition					M			R		R		
Holding Company Act	M	M	M	M/P	M	M	M/P	M/P	M	M	M/P	M/P
Holding Company Regulation	M	M	R	M	M	R		M	M	M	M	M
Standard Valuation Law	M	M/P	M	M/P	M	M	M	M	M	M	M	M
Credit for Reinsurance Act	R	R	R	R/P	M	R	M	M/P	M	M/R	M	R
Regulation for Life Reinsurance Agreements					M			M				M
CPA Audit Regulation			M	P				M/P		P		
Rehabilitation and Liquidation Model Act	R	R	M	R	M	M	M/R	R/P	M	R	R/P	R
IRIS Model Act	M			P	M		M	M	R	M	P	M
Risk Retention Act	M	M	R	R/P	M/R	M	M/R	M		M	R	M
Business Transacted w/Producer Controlled P/C Insurer Act (1)							M					
Managing General Agent Act (1)	P	M/P		P			M	R				
Reinsurance Intermediaries Act (1)	P			P				P				

LEGEND
M:Enacted Model/Similar Legislation
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(1)States Have Until 1992 to Adopt
(Information as of April 1991)

Table III.3: States' Adoption of NAIC Models Related to Accreditation

NAIC MODEL	STATE		
	WI	WV	WY
Examination Authority (1)	R	R/P	R
Regulation to Define Standards and Commissioner's Authority for Companies in Hazardous Financial Condition		M	
Holding Company Act	R	M	M
Holding Company Regulation	R		
Standard Valuation Law	M	M	M
Credit for Reinsurance Act		R	M/R
Regulation for Life Reinsurance Agreements			
CPA Audit Regulation	M	M	
Rehabilitation and Liquidation Model Act	M	M/R	R
IRIS Model Act		M	M
Risk Retention Act	R	M	M
Business Transacted w/Producer Controlled P/C Insurer Act (1)			
Managing General Agent Act (1)			R
Reinsurance Intermediaries Act (1)			

LEGEND
M:Enacted Model/Similar Legislation
R:Enacted Related Legislation/Regulation
P:Pending Legislation/Regulation
(1)States Have Until 1992 to Adopt
(Information as of April 1991)

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