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Ohio Department of Insurance
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December 16, 2011

Department of Treasury, Federal Insurance Office, MT 1001
1500 Pennsylvania Ave, NW
Washington, D.C. 20220

Re: Comments on the Report to Congress on How to Modernize and Improve the System of Insurance Regulation in the United States

Dear Director McRaith:

As Lieutenant Governor and Director of the Ohio Department of Insurance and on behalf of the State of Ohio, I appreciate the opportunity to comment on the Report to Congress on How to Modernize and Improve the System of Insurance Regulation in the United States. While I appreciate the efforts of the Federal Insurance Office (FIO) to enhance the regulation of insurers and protect consumers, I am concerned with any erosion or duplication of state authority in these areas.

The Ohio Department of Insurance aggressively monitors insurance companies to ensure products are fair and reasonable without placing unnecessary burden on companies. And as a state based regulator, we have close relationships with consumers, businesses and insurers in our market providing us the best opportunity to protect Ohioans.

Attempts by FIO to erode or duplicate our efforts could harm the balance we are committed to protecting and maintaining. As an accredited regulator by the National Association of Insurance Commissioners (NAIC) for 20 years, the Ohio Department of Insurance has demonstrated the expertise and capacity needed to thoroughly examine insurance companies in the most efficient and fair way possible while protecting consumers.

Therefore, I would strongly urge FIO consider leaving insurance regulatory powers and consumer protection to the states. FIO should also continue working with NAIC in order to better understand the complex nature of state based insurance regulation.

Ohio has prepared the following comments for FIO's consideration. Thank you for the opportunity to submit these comments.

Sincerely,

Mary Taylor

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Lieutenant Governor/Director of the Ohio Department of Insurance

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1. Systemic risk regulation with respect to insurance.

State-based regulation currently accounts for systemic risk. State laws prohibit insurance companies from business transactions that would cause systemic uncertainties. Regulatory tools, such as Risk Based Capital (RBC) and Insurance Regulatory Information System (IRIS) Ratios, aid in identifying and mitigating systemic risk. Insurers are subject to stringent laws and regulations and insurance regulators have broad authorities to examine all licensed insurers to identify and address issues before they become a threat to insurer solvency.

State insurance regulators utilize the financial statements and other information as part of their continuous, intensive financial analysis to identify issues that could impact solvency. On an ongoing basis, state insurance regulators assess business plans, material transactions, and any reputational or contagion risk posed by such transactions to determine whether to approve, deny, or require additional solvency protections. They analyze impacts of major economic and insurance events through the use of special data requests and stress testing. As part of our solvency system's "Windows and Walls" approach to group supervision, insurers are required to report on any reputational or other contagion risks posed by non-insurance affiliates, the "windows" into the rest of the group. At least every quarter, state regulators assess a company's reserve adequacy, leverage, liquidity, surplus sufficiency, asset quality, investment concentration, and other trends reflected in the filings. Every 3 to 5 years, state regulators engage in full scope on-site examinations of each insurer. Such examinations are risk-focused and are used as a means of validating that the insurer's systems are performing as claimed in their financial statements and regulatory filings.

Because of our in-depth, thorough processes and procedures regarding systemic risk regulation, we do not believe additional layers of regulation created by the Federal Insurance Office (FIO) are necessary. These responsibilities should be left to state regulators.

2. Capital standards and the relationship between capital allocation and liabilities, including standard relating to liquidity and duration standards.

These concepts are currently addressed by state-based regulation. The information provided by financial statements, which is audited by an independent accountant, is also used in the system's risk-based capital framework. This framework requires an insurer to hold at least a minimum amount of capital based on analysis of risks on the insurer's balance sheet and in its operations. This framework is comprised of a Risk Based Capital (RBC) calculation as well as statutory authority for successive levels of regulatory intervention based upon risks assessed in the formula compared to the insurer's capital amount. The formula applies factors to audited annual statement amounts for assets, premiums, claims, expenses, and reserves, and such factors increase for items with greater underlying risk. The RBC formula provides a minimum capital

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and surplus to support insurer risks such as: asset risk, (specifically the risk of default or fluctuation in fair value of investments); insurance risk or the risk of inadequacy of premiums and reserves; and interest rate, credit, or other market risk. A separate RBC formula is used for the life, fraternal, property and casualty, and health industries that reflect the unique investment, underwriting, and other risks to the sector. Due to the different types of risks insured by each company, a review of the duration of assets and liabilities is part of the evaluation of the solvency of each company.

Actuarial opinions are received and reviewed annually as required by the National Association of Insurance Commissioner (NAIC) Accreditation Standards.

The above strategies regarding capital standards demonstrate our commitment to high standards for insurers in order to protect consumers as well as the company. Additional efforts in these areas by FIO should not be pursued but instead left to the states.

3. Consumer protection for insurance products and practices including gaps in State regulation and access for traditionally underserved communities and consumers, minorities, and low- and moderate income persons to affordable insurance products.

A robust competitive marketplace results in the lowest cost to consumers. Each state has various residual market plans that provide coverage to high risk consumers. Additional regulation would just add to the cost of insurance products paid by consumers.

If an insurer does become insolvent, the state receivership laws give policyholders priority over almost all other claimants. In cases where the assets of an insurer are insufficient to pay policyholder claims, the states have guaranty funds to serve as a backstop and protect policyholders of most lines of life and property and casualty insurance. Similar to FDIC backing for bank depositors, guaranty funds cover an insurer's financial obligation to policyholders, annuitants, beneficiaries, and third party claimant's up to statutory limits. Together, the broad authorities provided to state insurance regulators under the state receivership laws and the guaranty fund backstop ensure that policyholders are protected and insurance company insolvencies are resolved in an orderly manner.

4. The degree of national uniformity of State insurance regulation, including the identification of, and methods for assessing excessive, duplicative or outdated insurance regulation or regulatory licensing process.

There is a high degree of uniformity due to the state accreditation program through the NAIC. NAIC accredited insurance departments are required to undergo a comprehensive review by an independent review team every five years, as well as an interim review annually, to ensure the departments continue to meet baseline financial solvency oversight standards. The accreditation

standards require state insurance departments to have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, as well as the necessary resources to implement and enforce that authority. Currently, all 50 states and the District of Columbia are accredited.

Currently large multi-state examinations are coordinated and require reporting to the NAIC Financial Examiners Coordination Working Group.

The Uniform Certificate of Authority Application (UCAA) process is designed to allow insurers to file copies of the same application for admission in numerous states. Each state that accepts the UCAA is designated as a uniform state. While each uniform state still performs its own independent review of each application, the need to file different applications, in different formats, has been eliminated for all states that accept the uniform application.

5. The regulation of insurance companies and affiliates on a consolidated basis.

State-based regulation already regulates insurers on a consolidated basis. The NAIC has identified all insurance groups and has the Financial Examiners Coordination Working Group that monitors all coordinated on-site financial examinations. Lead states have been identified for all insurance groups. All material agreements between affiliates must be approved by the state regulator.

As a result of the 'windows and walls' approach in the NAIC's Solvency Modernization Initiative (SMI), state regulators have a greater ability to see through the 'windows' to the dealings of an insurer's non-insurance affiliates while maintaining the 'walls' that protect the insurer from adverse consequences of problems generated by that non-insurance entity.

6. International coordination of insurance regulation.

Many state regulators that have companies in international groups attend supervisory colleges in order to facilitate regulatory coordination. The NAIC is a founding member of the International Association of Insurance Supervisors (IAIS), and is a committed participant in all of the major IAIS committees and subcommittees. The NAIC also serves as Vice-Chair of the IAIS Financial Stability Committee, which is currently in the process of developing a methodology for identifying insurers that may be GSIFIs.

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Because states (through their participation and coordination with NAIC) already address issues regarding international regulation, added layers and duplication of efforts by FIO is not necessary.

7. The costs and benefits of potential Federal regulation of insurance across various lines of insurance (except health insurance).

Costs would be prohibitive while producing few benefits. By establishing an optional system of federal insurance regulation, large companies would have the opportunity to choose between state and federal regulation resulting in the very same type of regulatory arbitrage that enabled the financial crisis to occur.

8. The feasibility of regulating only certain lines of insurance at the Federal level, while leaving other lines of insurance to be regulated at the State level.

There are too many problems in this approach. Who would be responsible for what? How would guarantee fund protection be addressed? By establishing an optional system of federal insurance regulation, large companies would choose between state and federal regulation resulting in the very same type of regulatory arbitrage that enabled the financial crisis to occur. Many large insurers write multiple lines of business. By regulating only certain lines of business at the federal level, costs would be significantly increased with redundant regulation.

9. The ability of any potential Federal regulation or Federal regulator to eliminate or minimize regulatory arbitrage.

As stated in previous sections, by establishing an optional system of federal insurance regulation, large companies would choose between state and federal regulation resulting in the very same type of regulatory arbitrage that enabled the financial crisis to occur.

10. The impact that developments in regulation of insurance in foreign jurisdictions might have on the potential Federal regulation of insurance.

State-based regulation currently works well in the international world. As stated in earlier sections, the NAIC is a founding member of the IAIS, and is a committed participant in all of the major International Association of Insurance Supervisors (IAIS) committees and subcommittees. The NAIC also serves as Vice-Chair of the IAIS Financial Stability Committee, which is currently in the process of developing a methodology for identifying insurers that may be GSIFIs. As part of that work, the insurance regulatory representatives to the Financial Stability

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Committee can consult with and seek the advice of fellow insurance regulators. It is critical for these members to access unique expertise in particular subject areas. This knowledge helps

ensure that appropriate methodologies are being considered, and gives members the insights of the hands-on regulators with respect to discussions of particular companies.

For these reasons, we do not believe there is any benefit to FIO participating in areas of international regulation already being addressed by states and the NAIC.

11. The ability of any potential Federal regulation or the Federal regulator to provide robust consumer protection for policyholders.

Ohio already has a robust consumer protection division and process. State regulators have decades of experience dealing with consumer complaints, rate filings and monitoring financial soundness. State regulators have a thorough knowledge of their marketplace. It would be difficult to believe that a federal agency, further removed from the consumer and the complaint, could provide similar robust consumer protection.

12. The potential consequences of subjecting insurance companies to a Federal resolution authority, including the effects of any Federal resolution authority:

i. On the operation of State guaranty systems, including the loss of guaranty fund coverage if an insurance company is subject to a Federal resolution authority;
ii. On policyholder protection including the loss of the priority status of policyholder claims over other unsecured general creditor claims;
iii. In the case of life insurance companies, on the loss of the special status of separate account assets and the separate account liabilities; and
iv. On the international competiveness of insurance companies.

There is no need for a Federal resolution authority. Insurance insolvencies are handled efficiently at the state level. Since 1987, the net assessments to state guarantee funds resulting from the ten largest insurance insolvencies amounted to $5,033,521,187. This total cost is less than half of the direct premiums written of the ten largest property and casualty insurers in a single year.

Source: National Conference of Insurance Guaranty Funds, via the Insurance Information Institute.