SENATE COMMITTEE ON INSURANCE
Senator Susan Rubio, Chair
2021 - 2022 Regular

Bill No:	AB 494	**Hearing Date:**	June 24, 2021
Author:	Mayes		
Version:	April 5, 2021		
Urgency:	No	**Fiscal:**	Yes
Consultant:	Brian Flemmer		

SUBJECT: Insurance Holding Company System Regulatory Act

DIGEST: Amends the Insurance Holding Company System Model Act and Model Regulation provisions to assist in the evaluation of insurance group risk and liquidity stress. This will help California retain accreditation from the National Association of Insurance Commissioners (NAIC).

ANALYSIS:

Existing law:

1) The McCarran-Ferguson Act, provides that as a matter of federal law, the regulation of insurance is to be carried out by the individual states (15 U.S.C. §§ 1011-1015).

2) Requires every insurer that is authorized to do business in this state and that is a member of in insurance holding company system to register with the Commissioner (CIC § 1215.4).

3) Provides for a number of financial solvency regulatory rules that both the Commissioner and insurers must comply with in order to satisfy NAIC "accreditation" requirements. These accreditation requirements take the form of NAIC recommendations, but as a practical matter, domestic insurers in a state that is not accredited face significant regulatory burdens in other states in which they do business (CIC §§ 1215-1215.18).

4) Requires the ultimate controlling person of an insurer subject to registration under the Insurance Holding Company System Regulatory Act to file an annual enterprise risk report as determined by NAIC procedures (CIC § 1215.4(m)).

5) Allows the Commissioner to share certain confidential documents obtained or disclosed pursuant to provisions of the Insurance Company System Company Regulatory Act to be shared with NAIC and its affiliates and subsidiaries under specified circumstances (CIC § 1215.8).

This bill:

1) Incorporates NAIC recommendations regarding a group capital calculation and a liquidity stress test into the Insurance Holding Company System Regulatory Act.

2) Requires the ultimate controlling person of an insurer subject to registration under the Insurance Holding Company System Regulatory Act to file an annual group capital calculation, unless a specified exemption applies.

3) Requires the ultimate controlling person of an insurer subject to registration under the Insurance Holding Company System Regulatory Act and scoped into the NAIC Liquidity Stress Test Framework to file the results of a specific year's liquidity stress test.

4) Allows the California Insurance Commissioner (Commissioner) to share certain confidential documents obtained or disclosed pursuant to provisions of the Insurance Company System Company Regulatory Act to be shared with the NAIC and a third-party consultant designated by the Commissioner.

Background

According to the author, "The National Association of Insurance Commissioners (NAIC) adopted revisions to the NAIC Insurance Holding Company System Model Act and Model Regulation last December. This proposal amends California law to assist in evaluation of insurance group risk and liquidity stress, and will help California retain NAIC accreditation for the California Department of Insurance."

The NAIC was established in 1871 by state insurance regulators. It promotes uniformity of financial reporting by insurers from one state to another. The NAIC is a non-profit entity consisting of the head insurance regulator for all 50 states and all 5 territories. It governs all forms of insurance and allows individual state insurance commissioners to coordinate their regulatory efforts with commissioners in other states.

The NAIC Financial Regulation Standards and Accreditation Program was established to develop and maintain standards to promote effective insurance company financial solvency regulation. The purpose of the accreditation program is for state insurance departments to meet baseline standards deemed essential for effective solvency regulation in each state and create a baseline level of effective financial regulatory oversight. Accreditation results in efficiencies for insurance regulators who are able to coordinate and rely on each other's work, and for insurance companies licensed in accredited states, which are then not subject to financial examinations, or other financial oversight, by multiple jurisdictions. All fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands are currently accredited.

Accreditation is a certification given to a state insurance department once it has demonstrated it has met and continues to meet an assortment of legal, financial and organizational standards as determined by a committee of its peers. The concept of accrediting state insurance departments began in the mid-to-late 1980s when several large insurance companies became insolvent. In May 1988, as a response to the insolvencies, a congressional inquiry began looking at the insolvencies. Subsequently, in September 1988, the NAIC began discussing and shaping the Financial Regulation Standards and Accreditation Program. In June 1989, the NAIC adopted the Financial Regulation Standards and a formal certification program in June 1990.

The accreditation program relies on state certification by other regulators (i.e., peer review), requires risk-focused financial surveillance including on-site examinations, and requires solvency-related model laws, rules, and guidelines produced through consensus and collaboration. Accredited insurance departments are required to undergo a comprehensive review by an independent review team every five years to ensure the departments continue to meet baseline financial solvency oversight standards. These departments are also required to undergo a desk audit annually. The accreditation standards require state insurance departments to have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, and that they have the necessary resources to carry out that authority.

Accreditation allows for inter-state regulatory cooperation and reduces regulatory redundancies. For instance, if a company is domiciled in an accredited state, the other states in which that company is licensed and/or writes business may be assured that, because of its accredited status, the domiciliary state is adequately monitoring the financial solvency of that company. In fact, other state Commissioners can accept the examination report prepared by another accredited insurance department in lieu of performing its own financial examination. This ultimately saves millions of dollars in duplicative regulatory costs, and the resultant uniformity and cooperation allows insurers to operate efficiently in multiple states.

2020 Revisions

In December 2020, the NAIC unanimously adopted revisions to the Insurance Holding Company System Model Act and Model Regulations in order to enable the requirement for the Group Capital Calculation (GCC) for insurance groups and the Liquidity Stress Test (LST) framework for large U.S. life insurance companies.

The NAIC started development of the GCC in 2015 in response to lessons learned from the 2008 financial crisis. It provides regulators an understanding of an insurance group's financial risk profile and the available capital/financial resources within the insurance group. While state insurance regulators currently have the authority to obtain information regarding the capital of non-insurance affiliates, they do not have a consistent analytical framework for evaluating such information.

The GCC is designed to address this shortcoming and will serve as an additional financial metric that will assist state insurance regulators in identifying risks that may emanate from a holding company system. More specifically, the GCC and related reporting provides more transparency to state insurance regulators regarding insurance groups and make risks more identifiable and more easily quantified.

The LST as a regulatory tool was developed starting in 2017 as part of a larger initiative to enhance risk identification efforts by building on the state-based regulation system. It provides state insurance regulators with insights and the ability to assess key macro-prudential impacts on the broader financial markets and the related risks that are monitored by the Financial Stability Oversight Council and other jurisdictions internationally. It also enhances group supervision, and requires every insurer subject to registration to file the results of a specific year's liquidity stress test to the lead state insurance commissioner.

There is a potential consequence for failure to adopt this regulatory act in the form of lost accreditation status. The NAIC has recommended this accreditation standard become effective in November 2022 with enforcement of the standard to commence on January 1, 2023.

Related/Prior Legislation

AB 2049 (Cooley) Chapter 71, Statutes of 2020, updated California insurance law to conform to recent changes to the Credit for Reinsurance Model Act adopted by the National Association of Insurance Commissioners (NAIC).

AB 938 (Cooley) Chapter 202, Statutes of 2017, authorized the commissioner to adopt regulations applicable to aspects of reinsurance arrangements for certain life and universal life insurance policies, long-term care policies, variable annuities, and other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance.

SB 1216 (Lowenthal) Chapter 277, Statutes of 2012, incorporated changes to the NAIC model act adopted in response to Dodd-Frank.

SB 696 (Roth) Chapter 658, Statutes of 2015, conformed California law to the model Standard Valuation Law, adopted by the NAIC, and replaced the method of calculating reserves for most life insurance products with a new method known as principle-based reserving (PBR) for contracts issued on or after the effective date.

ARGUMENT IN SUPPORT:

Supporters generally argue this legislation will help CDI better evaluate insurance group risk and liquidity stress of insurance companies to understand their financial risk profile and solvency.

The California Insurance Commissioner, Ricardo Lara, writes in support, “This bill contains the National Association of Insurance Commissioners’ (NAIC) adopted revisions to the NAIC Insurance Holding Company System Model Act and Model Regulation last December. This proposal amends California law to assist in evaluation of insurance group risk and liquidity stress, and will help California retain NAIC accreditation for the California Department of Insurance.”

SUPPORT:

California Department of Insurance (Sponsor)

OPPOSITION:

None Received (June 16, 2021)

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