

August 9, 2005

Dear Commissioner:

The NAIC-AICPA Working Group is crafting a proposal to add Sarbanes-Oxley inspired internal control rules to the current system of insurance solvency regulation. Soon, you will be asked to consider its merits and should be aware of comments by one of its principal authors as reported in the *Financial Times* ("Sarbanes-Oxley law goes too far, admits its author," July 7, 2005, link attached). I'd like to draw your attention to four primary points that emerge from the article:

1. The co-sponsor of the bill, Congressman Michael Oxley, has acknowledged that the law's attempt to reform corporate accounting and governance practices were "excessive." Speaking to a meeting of the International Corporate Governance Network (ICGN) in London, Congressman Oxley attributed the Act's flaws to the "hothouse atmosphere" that prevailed at the time of the law's enactment, which he says prevented lawmakers from behaving "responsibly." That assessment echoes the findings of the *NAMIC Issue Analysis*, "It's Time to Admit that SOX Doesn't Fit: The Case Against Applying Sarbanes-Oxley Act Governance Standards to Non-Public Insurance Companies."
2. Congressman Oxley reaffirmed that the purpose of Sarbanes-Oxley was to protect public company investors and enhance "the strength of the U.S. capital markets." Also consistent with the NAMIC paper, this raises the question of why one would expect an investor-protection measure, now admitted to be flawed, to function as a reasonable, cost-effective measure to reduce insolvencies among non-public insurance companies. This point is especially salient when one considers that mutual companies have accounted for only five percent of insurer insolvencies in the accreditation era.
3. Congressman Oxley suggests that if he could re-write the law *knowing what he knows now*, he would do things differently. While members of Congress didn't have the benefit of hindsight when they drafted SOX in 2002, state insurance regulators looking to SOX as a possible model for insurance solvency regulation do. There is a wealth of evidence they can draw upon to determine whether, and at what cost, SOX is worth emulating and it continues to show that the Sarbanes-Oxley Act is "not a perfect document," as kindly put by Rep. Oxley.
4. A bad law, once enacted, is exceedingly difficult to get rid of. "Congress will not revisit this issue," he declared after criticizing the law, nor, he added, would the SEC institute reforms designed to reduce the compliance burden on small companies. The institutional inertia that prevents policymaking bodies from correcting their mistakes is one more reason why state insurance policymakers should move cautiously in considering changes to the current system of solvency regulation.

Congressman Oxley's statements are important and timely. It is yet another strike against efforts to bring Sarbanes-Oxley into the insurance solvency realm including opposition by the National Conference of Insurance Legislators (NCOIL) last March. Legislative resistance to the proposal

persists. Just last Friday a task force of the American Legislative Exchange Council (ALEC) unanimously passed a resolution against applying SOX-like elements to non-public insurers. Considering that solvency regulators have suggested they will seek legislative approval of the proposal, outright opposition of state lawmakers to the application of Title IV internal controls to non-public insurance companies is not promising.

From the start, this has been a mismatch of public policy to desired objective; Sarbanes-Oxley was intended to restore confidence in the capital markets and solvency regulation exists to protect insurance policyholders. Also known is that costs are excessive for what it purports to accomplish; that for every dollar of maximum possible benefit (elimination of mutual company insolvencies) it would cost insurance companies eight dollars to comply with Title IV as originally proposed. Now Congressman Oxley, a principal author of the statute, has confirmed that it is flawed, *even in its original context of bolstering the capital markets*.

NAMIC is sympathetic to what we perceive as the sincere determination of regulators to improve oversight of insurance company solvency. We have consistently supported a substantive debate appropriate for a major public policy initiative including a national, comprehensive evaluation of the cause of insolvencies; a review of existing solvency laws; followed by consideration of cost-effective remedies if they are warranted. A projection of the fiscal impact on state departments of insurance faced with enforcing these potentially massive new requirements should also be part of the evaluation.

Companies of all sizes need adequate internal controls but mandatory requirements based on public company shareholder protection laws costing far more than the benefits they might possibly provide are not good public policy. Its transfer to an area for which it is not intended when the tools exceed what is needed in its original context will reflect badly on state insurance regulation.

As this issue becomes more prominent, I hope these observations prove helpful to you. Please let me know if you have any questions that I or anyone else at NAMIC can answer.

Sincerely,



Roger H. Schmelzer
Senior Vice President-State and Regulatory Affairs

Attachment

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