

Comments on the NAIC's
"Proposed 2006 Budget and Business and Fiscal
Impact Statements"

Submitted By

National Association of Mutual Insurance Companies

Prepared By William Boyd, NAMIC Staff

For the Public Budget Hearing November 3, 2005

I. Introduction

The National Association of Mutual Insurance Companies (NAMIC) comprises approximately 1,300 property-casualty insurers doing business in the United States, Canada, and Europe, which membership includes approximately 1,200 primarily mutual insurers currently writing more than 41 percent of the property-casualty premium in this country. With that major presence in the property-casualty market in the United States, NAMIC thereby welcomes opportunity to review, and comment on the proposed budget of the NAIC, the central organization of state regulation that so profoundly affects conduct and governance of the insurance business in the United States.

NAMIC here reiterates its dedication to the proposition that the states and like political subdivisions, rather than the federal government, should regulate insurance in this country. We observe that the federal government, by one or another of its branches, finds cause on occasion to criticize the state regulation of insurance and, explicitly or implicitly, to suggest or threaten that such regulatory authority be removed in some measure from the states' purview in favor of federal authority. The states' power to regulate insurance is best supported and maintained by continuing concentration on oversight that economically and efficiently directs resources to those areas of solvency and market conduct that protect policyholders and the insurers that serve them.

II. General Comments:

The greater transparency we observed and applauded in comments on the proposed NAIC budget for 2005 continues. An organization's expected resources and its intended uses of those resources are critical information for understanding how that organization has and will conduct its business. Indeed, revenues sought and allocations of expense may be the most explicit statement of any organization's purposes and how they will be achieved.

We have chosen in prior years' comments on the proposed budget to visualize, using budget-document numbers, aggregate changes in the NAIC budget on the basis of budgeted amounts for the coming year *versus* amounts projected for completion of the current year. Although "budget-to-budget" comparison is useful, we believe comparison on a "projected actual-to-budget" basis would seem to offer somewhat greater adherence to current fact. Our computations on that basis show the following:

Consolidated Net Budget

	2005 Projected (000)	2006 Budget (000)	Change
Revenues	\$58,390	\$59,339	1.6 %
Expenses	56,221	58,335	3.8 %
Remainder	\$ 2,169	\$ 1,004	(53.7) %

With the modest expected increase in revenues for 2006, we note the dissonant rise in expenses of 3.8 percent. We suggest that, given an overall survey of plans for 2006, and what those plans portend for later years, that caution needs to be exercised now against still more material expense growth in later years and the revenue requirement that can be expected to accompany it. The current request for five additional headcount may amount to confirmation of scenario for growth in expense and revenue. Similarly, in view of the diminished remainder shown above, the resolution to enhance either liquid reserves or operating reserves (more below) suggests that significant pressure for revenue growth will soon be present. As we have emphasized in past years' budget testimony, control and delay of incremental expense is a powerful tool in budget control and one that forces evaluation of current and planned projects as to their benefit to the states and the regulation they perform.

III. The Revised Metric For A Reserve; The Database Fee

Although asset amounts are not available in the budget document for computing comparisons of the "Operating Reserve" as formerly used and the current "Liquid Reserve" measurement, we would expect that the 80 percent target for "Liquid Reserve" has nearly been reached and, were the 100 percent "Operating Reserve" still applicable, it too would be on the cusp of achievement. What we would remark further in support of that suggestion, is that the NAIC would, with completion of the 2006 budget year, be within the lower boundary of the Tate & Tryon recommendations for a viable "Liquid Reserve." The budget document's estimate is for a "Liquid Reserve" of 69.2 percent at the close of 2006.

Moreover, we repeat our observation from a prior year that the NAIC's sources of revenue are broadly based in terms of the large number of insurers subject to NAIC exactions and broadly based also in terms of different products. We acknowledge that a small element of volatility is introduced with diminished dependence on database-fee revenue and corresponding greater reliance on other products. Yet so many of those other products appear highly proprietary to the NAIC that risk to aggregate NAIC revenues may be minimal.

NAMIC is appreciative of the NAIC using a focus group to consult the industry about its perceptions of the database fee and means for operating associations. That we currently see database-fee revenue diminishing in importance among all sources of NAIC revenue is a sign that the leadership is listening. Although we understand there is some flexibility with respect to the pending change to the database-fee schedule to further reduce such revenue, we believe intent should be given effect.

Still, the database fee clearly continues as the NAIC's largest single source of revenue. For reason of this status NAMIC has a number of times in previous budget comments recommended full program budgeting be used and disclosed for NAIC budget purposes, particularly in relation to that part of the budget for database fees. What the NAIC publishes early in the year is only partial fulfillment of that request. Full assignment of database-fee revenues to programs has not been made.

IV. Specific Reservations, Recommendations, and Questions

- The SVO's proposal for a "pre-examination analytical product" appears to be 1) a proposal for a digest of elements available in part through the Annual Statement; 2) a stalking horse for still broader "portfolio" analysis; and 3) as is averred by the financial impact statement, a "revenue enhancement opportunity." From the hypothetical "Portfolio Analysis Memorandum" included, we would suggest that the NAIC database, along with the individual company's Annual Statement, already itemizes and collates content of a company's investment portfolio. Pre-examination preparation by an examiner should already include such organization. Examination work itself should include identification of those securities that fail to provide return. Most important, the examiner—not someone at the NAIC—should be working to determine whether the portfolio conforms to the state's investment statute or comports with the company's investment plan, or both. What we observe in this proposal is displacement of preparation that should be performed by the examiner to the NAIC. The latter may be able to identify and categorize as to risk characteristics more obscure investment products and, indeed, ought to be used for that purpose. Yet the proposal seems most of all to intend enhancement of the SVO's mission and revenue for minimal gain in the solvency regime. We must further ask: How many insurers fail for reason of bad investments? Addition of two new analysts for the purposes proposed does not seem reasonable in any respect. We recommend that the SVO's operations be constrained to existing levels.
- Although it appears not to be a specific proposal for recognition of its fiscal impact, we must ask for further explanation of the "Regulatory Modernization and Initiatives Fund," as described in minutes of the August 26, 2005, teleconference of the Internal Administration Subcommittee. Mentioned in connection with establishment of the "Liquid Reserve" approach, this fund appears to be an encumbrance of the reserve carried by the NAIC. It is further identified as an

“established spending guideline” for new initiatives and proposals made during 2006” We ask for explanation of this fund or element of the reserve, given its magnitude.

- Very substantial additional travel is contemplated for 2006 to the extent of \$267,000 more than was budgeted for 2005. As we have noted in past comments, this appears to represent still more migration of expense for state regulators from their individual state budgets to the more malleable NAIC budget. State regulatory purposes are clearly involved. Are states not able to commit these resources to training of their insurance regulators? We see also \$50,000 allocated to Congressional delegations traveling to catastrophe sites. Does Congress not have enough money for this? Is this appropriately an NAIC obligation? And, further, what of \$150,000 allocated to speaking engagements with trade associations?
- The planned 24.4 percent revenue enhancement allocated for NAIC Zones begs for re-evaluation we believe. What specific expenses beneficial to policyholders are undertaken in this category, and what additional is planned.
- Does the planned \$148,000 renovation of the NAIC’s Washington, D. C., importune to an extent that it cannot be postponed or diminished in scale? What shortcomings or problems demand this extent of renovation now. How many people are resident in this office?

V. Conclusions

Despite the modest revenue increase budgeted, the increase in expenses now visible for 2006 has probability to presage significant need for additional revenue in succeeding years. Control and moderation should be applied now to expenses. The “Liquid Reserve” ratio should be regarded as having reached a prudent level at the end of 2006 for an organization with very broad-based revenue sources.