Testimony of Michael McRaith, Director of Illinois Department of Insurance
Hearing on Systemic Risk and Insurance - June 16, 2009

McRaith represents the opinions of the National Association of Insurance Commissioners and believes that financial stability requires cooperation among financial regulators. He testifies that most state insurance regulators hold the view that a systemic risk is posed when an entity's actions can have broader effects on the financial system. According to a G30 report, considerations for systemic risk include size, leverage, scale of interconnectedness, and systemic significance of infrastructure services. Importantly, McRaith testifies that insurance companies are the receivers, not creators, of systemic risk. He notes that the "too big to fail" concept does not apply to insurers because the state-based guaranty system isolates failures of certain lines and marketplace competition would allow troubled enterprises to be purchased by a third party. From this he concludes that any regulation of the insurance industry should be built around the idea that insurers do not generate risk, but facilitate underlying transactions whose proliferation may pose a systemic risk. He discusses the regulations that may be needed. First, he states that a council of regulators composed of state insurance regulators and members of state and federal agencies may be necessary. Second, he emphasizes that the state-based system is the best way to regulate insurance because the consolidation of regulatory power into a single entity creates the potential for more mistakes. State regulators have a better grasp on the knowledge and information specific to their arena. Third, any federal regulatory scheme must be integrated with the state system and allow for information sharing and formal collaboration among regulators. Federal legislation for confidentiality and other protocols may be necessary to facilitate this. Fourth, functional regulators and financial stability regulators should establish best practices for enterprise risk management and preemption of functional regulation authority should be limited and necessary. Finally, regulation must be transparent, accountable, and collaborative.

McRaith notes a number of international developments that could affect the U.S. insurance industry. First, a convergence project between the U.S. Financial Accounting Standards Board and the International Accounting Standards Board, under which the U.S. will accept the International Financial Reporting Standards. Second, there are a number of international efforts to converge financial regulatory standards, including the G20's International Association of Insurance Supervisors and the EU's new Solvency II legislation.

McRaith maintains that there is sufficient interaction and cooperation between U.S. regulators and international regulators. The NAIC provides a forum for both national and international dialogue among regulators. The NAIC also holds leadership positions in international regulator bodies and is a technical expert for many federal agencies.

The NAIC monitors cross-border capital flows and has an Accreditation Program that establishes minimum solvency standards and allows for periodic on-site evaluations. He also has faith in the guaranty system to protect policy holders and prevent the spread of insurance failures. However, because the effectiveness of the guaranty system depends on the ability of state regulators to monitor and regulate solvency, thus state regulatory authority should not be compromised. McRaith concludes that any mechanism designed to resolve systemic risk posed by complex financial institutions should involve state authority.