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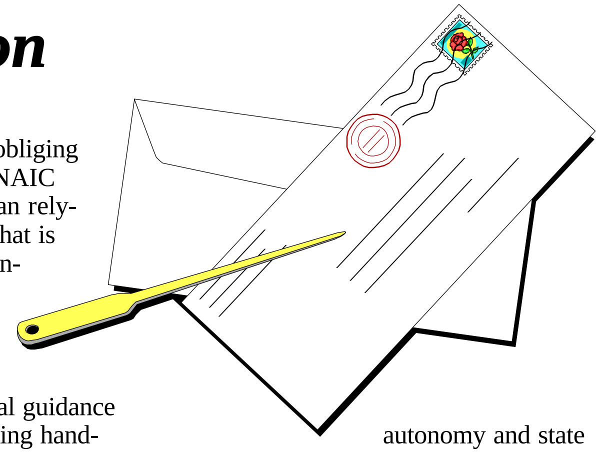
A Commissioner on Codification



Editor's Note: *The following originally appeared in a Letter to the Editor in the January 12, 1998 issue of the* National Underwriter *and is reprinted here with permission.*

TO THE EDITOR:

I have read several *National Underwriter* articles written from different perspectives regarding the National Association of Insurance Commissioners' project to codify statutory accounting (codification). What seems to be missing from that mix is any recognition that the core of the codification project is an important update of the accounting practices and procedures handbook that guides examiners and auditors nationwide. The current NAIC handbook is not controversial; in fact, it provides a baseline and coordination between the states for the very backbone of insurance regulation—monitoring the financial solvency of insurance companies. Several peripheral issues currently threaten this necessary update, not the least of which is the balance between coordinating regulation across state lines and states' rights to regulate independently. Codification gets my vote as soon as we set aside these peripheral issues and get down to the invaluable core.

No commissioner has ever told me that an acceptable result of codification would include a reduction of the authority and autonomy state regulators are given by their legislators. Yet, and seemingly by accident, the current codification work product does just that by eliminating prescribed and permitted practices from the current statutory accounting hierarchy and by penalizing commissioners for permitting practices consistent with the authority delegated to them by their legislatures. By requiring adverse audit opinions for companies that follow state permitted practices, the NAIC would be obliging those companies to follow the NAIC codification standards rather than relying on their state regulators. That is a vast departure from today's environment under which legislatures and regulators regularly determine the proper local accounting treatment and the NAIC provides technical guidance and support through its accounting handbook.

The EX(4) committee attempts to address part of this unintended consequence by adopting language allowing state to "opt out" of the investment benchmark disclosure piece. But that required individual state action to avoid the results of NAIC policy making—a significant change from our traditional system of creating models for each state to adopt or ignore. Moreover, it is unclear whether any state choosing to opt out would continue to enjoy NAIC support for the maintenance and upkeep of the current accounting practices and procedures manual. Finally, if state accreditation depends upon audits performed under these new standards, the entire codification would be delayed by the accreditation process, or that process would have to be circumvented. I doubt any commissioner wants to try explaining the resulting loss of autonomy to a government or legislature.

The technicians and staff have tried in earnest to do solve these problems. In some cases the solutions failed to solve the political consequences of expanding the scope of NAIC technical guidance. This is not an unexpected outcome given that commissioners' staff, not the commissioners themselves, have participated in the details of this project thus far. It is now time for the commissioners to consider and resolve the issues that create the political consequences. Commissioner Musser recognized the importance of legislative autonomy and state regulators' authority and some of the impact of codification on those ideals. At her last meeting she wisely chose to refer the codification project for further refinement, and to provide the NAIC with an opportunity for further review by commissioners.

The NAIC is at another important crossroads in deciding the outcome of codification. The controversial, peripheral issues need to be debated by commissioners without regard to parochial industry needs, goals of the AICPA, or the sensibilities of the very talented technicians who have worked hard to produce the codification product. In light of goals, comments, and concerns expressed by the AICPA, NCOIL, and interested parties from industry, these matters need to be decided by the chief regulator in each state. I urge my fellow commissioners to review codification thoroughly, discuss it with their governors and legislatures, contact the affected parties, and provide immediate input to the special ad hoc task force on codification so we can move this project forward without compromising important updates to the NAIC accounting practices and procedures manual. If we need to adopt benchmarks or encourage accounting uniformity beyond what we have today, let's pursue those without compromising the autonomy preserved by our current model-based system.

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