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NONADMITTED AND REINSURANCE REFORM ACT OF 2006

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

H.R. 5637

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NONADMITTED AND REINSURANCE REFORM ACT OF 2006

TUESDAY, SEPTEMBER 19, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:05 a.m., in Room 2141, Rayburn House Office Building, the Honorable Chris Cannon (Chairman of the Subcommittee) presiding.

Mr. CANNON. Good morning. This hearing of the Subcommittee on Commercial and Administrative Law will now come to order. We are here today to consider H.R. 5637, the "Nonadmitted and Reinsurance Reform Act of 2006."

Insurance is a highly regulated industry, but unlike banking and securities, insurance is regulated mainly at the State level. The Supreme Court ruled that Congress has the power to regulate insurance, but in 1945 this power was delegated to the States in the McCarren-Furguson Act and specifically reaffirmed in the 1999 Gramm-Leach-Bliley Act.

Every State requires licenses for insurance companies and regulates both the conduct and the details of the products sold within the State. This regulation is seen as important for consumer protection, but also creates barriers to entry in the insurance market and can reduce the supply of insurance that is available. Some argue that uniformity in insurance regulation is desirable, unlike the significant variation in current State regulations.

H.R. 5637 addresses two areas of the insurance industry. The first is nonadmitted insurers. There are certain times when it is not possible for the citizens of one State to find licensed insurers to cover his or her unique risks. In situations where consumers are unable to find insurance from licensed insurers within their State, States do not require that the consumers go without insurance. Instead, States allow nonlicensed insurers, known as nonadmitted or surplus line insurers, to provide insurance. The vast majority of nonadmitted insurance policies are sold to sophisticated businesses and cover specialized risks such as terrorism, catastrophic losses, hazardous materials, natural disasters and environmental or pollution risks.

Although these insurers do not have a regular State license, they are not unregulated. The sale of insurance is still regulated and taxed by the States through requirements placed on the brokers facilitating the insurance transactions. States collect premium taxes

for nonadmitted insurance placements, but the tax allocation and remittance formulas and procedures vary significantly from State to State, and are often in direct conflict. When a nonadmitted policy involves multistate risk, it can be difficult to determine how much tax is owed to each State, and as a result, multiple taxation or noncompliance may occur.

The second area of the insurance industry that H.R. 5637 addresses is reinsurance. Reinsurance is insurance for insurance companies. When an insurance company has written a policy covering a large risk, it will insure part of its risk through other insurers thereby transferring a portion of its risk. Reinsurance allows an insurer the ability to increase its capacity and underwrite more coverage, performing an essential role in the insurance marketplace by limiting insurers' liability exposure, adding insurance capacity, and protecting against large, unexpected losses.

H.R. 5637 was written to affect a narrow area of insurance reform. It is aimed at addressing inconsistencies of State regulation in the surplus lines insurance market and streamlining its procedure. It creates a uniform system for nonadmitted insurance premium tax payments by making the taxing authority the home State of the policyholder. Further, it encourages States to develop a procedural mechanism for uniform tax allocation through an interstate compact or other method, and establishes regulatory deference for home insurers as developed and promulgated by the National Association of Insurance Commissioners in the Nonadmitted Insurance Model Act.

The bill also applies a single State regulation for financial solvency and credit reinsurance of reinsurers. Determinations of tax credits for reinsurance will be controlled by the home State of the insurer purchasing the reinsurance. The regulations of the home State of the reinsurer will control in determinations of solvency of the reinsurer provided such State is NAIC-accredited or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation.

I look forward to learning more about H.R. 5637 and to hear the testimony of our panel.

Without objection, the Chair will be authorized to declare recess of the hearing at any point. Hearing none, so ordered.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Good morning, this hearing of the Subcommittee on Commercial and Administrative Law will now come to order.

We are here today to consider H.R. 5637, the Nonadmitted and Reinsurance Reform Act of 2006. This bill deals with two different areas of the insurance industry. The first are is nonadmitted insurers.

Insurance is a highly regulated industry. Unlike banking and securities, though, Congress, under the McCarren-Furguson Act, has granted the States the ability to regulate insurance. Every State requires licenses for insurance companies and regulates both the company conduct and the details of the products sold within the state. This regulation is seen as important for consumer protection, but also creates barriers to entry in the insurance market, and can reduce the supply of insurance that is available.

There are certain times when it is not possible to find licensed insurers to cover unique or hard to place risks. In these situations where consumers are unable to

find insurance from licensed insurers, States do not require that the consumers simply go without insurance. Instead, States allow non-licensed insurers, known as nonadmitted or surplus line insurers, to provide insurance in this circumstance. The vast majority of nonadmitted insurance polices are sold to sophisticated businesses and cover specialized risks, such as extreme catastrophic coverage and terrorism, hazardous materials, natural disasters, and environmental or pollution risks.

Although these insurers do not have a regular state license, they are not unregulated. The sale of insurance is still regulated and taxed by the States through requirements placed on the brokers facilitating the insurance transactions. States collect premium taxes for nonadmitted insurance placements, but the tax allocation and remittance formulas and procedures vary significantly from State to State and are often in direct conflict.

When a nonadmitted policy involves multi-state risk, it can be extremely difficult to determine how much tax is owed to each State and, as a result, multiple taxation or noncompliance often results.

The second area of the insurance industry that H.R 5637 addresses is reinsurance. Reinsurance is insurance for insurance companies. When an insurance company has written a policy covering a large risk, it will insure part of its risk through other insurers thereby transferring a portion of its risk exposure to a reinsurer. Reinsurance allows an insurer the ability to increase its capacity and underwrite more coverage, performing an essential role in the insurance marketplace by limiting insurers' liability exposure on large risks, adding insurance capacity, and protecting against large unexpected catastrophes.

H.R. 5637 was written to affect a narrow area of insurance reform. It is aimed at addressing inconsistencies of state regulation in the surplus lines insurance market and streamlining its procedure. It creates a uniform system for nonadmitted insurance premium tax payments by making the taxing authority the home State of the policyholder. Further, it encourages States to develop a procedural mechanism for uniform tax allocation (through an interstate compact or other method), and establishes regulatory deference for home insurers as developed and promulgated by the National Association of Insurance Commissioners (NAIC) in the Nonadmitted Insurance Model Act.

The bill applies a single State regulation for financial solvency and credit reinsurance of reinsurers. Determinations of tax credits for reinsurance will be controlled by the home State of the insurer purchasing the reinsurance. The regulations of the home State of the reinsurer will control in determinations of solvency of the reinsurer provided such State is NAIC-accredited or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation.

I look forward to learning more about the insurance industry and H.R. 5637, and to hear the testimony of our panel.

Mr. CANNON. I ask unanimous consent to enter into the record a statement by the sponsor of H.R. 5637, the representative from Florida, Ms. Brown-Waite, and that Members have 5 legislative days to submit written statements into the record. Without objection, so ordered.

[The prepared statement of Ms. Brown-Waite follows:]

PREPARED STATEMENT OF THE HONORABLE GINNY BROWN-WAITE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Thank you Mr. Chairman for holding this hearing today.

And I want to thank the witnesses for being here today as well.

The House of Representatives has been engaged in overall insurance reform for several years, and in this endeavor, there are dozens of issues the Congress must consider. I have introduced H.R. 5637, the Nonadmitted and Reinsurance Reform Act that will provide solutions to two aspects of that reform.

Today, the regulation of the surplus lines market is fragmented and cumbersome. Insurers and brokers who want to provide insurance across state lines are subject to a myriad of different state tax and licensing requirements. For instance, if a company in Florida wants to transport a product, say parts for the space shuttle, to Houston, TX, the non-admitted insurance company they use must comply with the regulations of at least five different states. Often times, these regulations will conflict, making it impossible for one company to comply with all of them. This situation leaves policyholders underinsured and with little choice in providers.

Moreover, most of the policyholders that purchase insurance in the nonadmitted market do so everyday. These "sophisticated" commercial entities have educated

risk advisors on staff with a thorough understanding of the market and their risk exposure. Yet in most states, these companies are required to shop around the admitted market and be denied for coverage they know they cannot get before they are permitted to shop in the surplus lines market. This practice is needless and cumbersome, and only adds to the cost for the policyholder.

On another front, in the reinsurance market some state regulators are taking it upon themselves to throw out arbitration agreements between reinsurance providers and primary carriers. These are contractual agreements decided upon by sophisticated parties on both sides of the transaction to settle disputes without tying up the courts. If these agreements are valid in a state that is accredited by the NAIC, they should be valid in all accredited states.

Accordingly, H.R. 5637:

- Specifies that only the tax policies and licensing regulations of the state in which the policyholder is domiciled govern the transaction. States may still enter into tax allocation and remittance agreements with other states, but this bill specifies which law will take precedence, thus taking the guesswork out of the process. Insurance providers therefore need only comply with those of the policyholders' state in one transaction.
- Requires states within two years of bill passage to participate in the National Association of Insurance Commissioners' national insurance producer database and adopt regulations under NAIC's Nonadmitted Insurance Model Act.
- Allows sophisticated commercial entities direct access to the surplus lines market.
- Prohibits states from voiding established, contractual arbitration agreements between reinsurers and primary companies.

Obtaining insurance for unique or high-risk products in the nonadmitted market already has its own obstacles. Adding a quagmire of inefficient state rules does not help. And with reinsurance rates rising at an alarming rate, companies should be encouraged to stay out of the courts and follow their own arbitration agreements.

My bill provides commonsense solutions to the nonadmitted and reinsurance market, and I thank the Chairman for holding this hearing on it today.

Mr. CANNON. I now yield to Ms. Wasserman Schultz, who is sitting in for Mr. Watt today, for an opening statement.

Ms. WASSERMAN SCHULTZ. Thank you. Thank you, Mr. Chairman, for convening today's hearing.

And I especially want to thank Ranking Member Watt *in absentia*. It's not all that often that a freshman gets to sit in this chair, so I think I'll hold onto it for a little bit and glory in it.

I also want to welcome all of our panelists and extend a special welcome to my good friend, Alex Soto, current President of the "Big I," otherwise known as the Independent Insurers & Brokers of America, but it's actually known as the "Big I." and Alex hails from Miami, and he has been a good friend to me over the years. We have worked together on many, many issues, not always on the same side, but on many, many issues; and he is a tremendous advocate for his industry.

The problem that we're here to talk about today is not only endemic to Florida, though, in spite of the fact that this is a bill that's sponsored by a Member from Florida, this is a problem that is really extremely broad based nationwide. The economic resonance from disasters like Hurricanes Katrina, Rita and Wilma, has left an indelible fingerprint on our Nation, and our country now faces a crisis in its insurance markets the likes of which we have not witnessed before. And it's not only price, but availability.

Recent catastrophes have reshaped our Nation's personal and commercial insurance markets, making it even more difficult for affected regions to recover. Market perception of exponential increases in the risk affiliated with catastrophic events has resulted

in precipitous declines in insurance coverage availability at astronomical cost to policyholders.

In addition to my role on this Committee, I serve on the House Financial Services Committee, as well, and we have held a number of hearings on this matter and are considering how best to resolve this problem. I believe an essential component for that solution, Mr. Chairman, is the establishment of a national catastrophe fund. To that end, I've introduced legislation H.R. 5891, the Catastrophic Disaster Risk and Insurance Commission Act of 2006, which would bring together a few stakeholders to develop a comprehensive solution to this national problem.

The only way we were able to establish a State catastrophe fund in Florida following Hurricane Andrew, Mr. Chairman, was when we brought the stakeholders to the table, had a technical advisory panel and advised a statewide task force that was chaired and the members of which were our university presidents; and they made recommendations to the Florida legislature, and ultimately we were able to come to agreement on that issue.

While the bill before us today is only a small piece of the puzzle, it is an essential first step, which eliminates market inefficiencies and reduces duplicative and costly filing burdens. I encourage my colleagues here today to move this legislation forward.

The surplus lines market serves as a safety valve for the traditional market. In my home State of Florida both individuals and commercial entities are seeing astronomical increases, and I am talking on the order of thousands of percent increases in their insurance premiums. Under the existing system of insurance regulation, surplus lines serve an extraordinarily valuable purpose to hedge against some of these natural disaster risks. Don't get me wrong, they're not perfect, but in some instances it is the only way commercial firms and individuals can get adequate coverage for wind exposure.

As a original cosponsor of this legislation, I am proud of the Financial Services Committee's concerted effort to ensure that concerns from both sides of the aisle were incorporated into the bill before it was reported unanimously. In its current form, the legislation includes a number of provisions inserted at the behest of Financial Services Ranking Member Barney Frank and Subcommittee Ranking Member Paul Kanjorski; and these include, Mr. Chairman, provisions to address concerns raised by the NAIC, the National Association of Insurance Commissioners, adjustments to the allocation of premium taxes amongst the States, a clarification to underscore that the bill does not preempt State laws restricting the placement of worker's compensation coverage with a nonadmitted insurer, as well as a handful of technical corrections.

The second title on reinsurance was revised to ensure that the State with the greatest interest in protecting the consumer, in this case the primary insurer, makes the appropriate decisions. The definition of a reinsurer was also changed to ensure that the domiciliary oversight does not unfairly advantage their primary insurance business.

And I think it's important to reiterate that this bill only applies to sophisticated insurance lenders, not individuals. The Risk and

Insurance Management Society, or RIMS, which represent commercial policyholders fully supports the legislation.

I encourage my colleagues to support this bill because it reduces economic inefficiencies and would eliminate hundreds of billions of dollars in administrative costs. These costs are currently passed on to consumers. Surplus lines ensure that companies that otherwise could not get insurance are able to obtain it, meaning they can also stay in business, provide jobs and serve communities.

Thank you. I yield the balance of my time.

Mr. CANNON. Thank you.

Please note Mr. Bachus may join us; he is a co-sponsor of the bill, and I mention it just because he is not a Member of the Subcommittee, although he's a Member of the Judiciary Committee; and we have arcane rules, and that requires that if he—requires that if he asks questions, he has to have time yielded to him, which we will make sure happens. I just want you to understand in advance.

Our first witness is Mr. Scott Sinder, who is a member of the Washington, D.C., law and government relations firm, The Scott Group, and since 1999 has served as the outside General Counsel for the Council of Insurance Agents & Brokers. Mr. Sinder has represented the CIAB on a range of issues in Federal courts, regulatory agencies, State legislatures and before Congress.

Well, we have The Scott Group.

Mr. Sinder received his J.D. from the University of Michigan Law School and his Master's in public policy from the University of Michigan Institute of Public Policy Studies.

Our second witness is Ms. Tracey Laws, the Senior Vice President and General Counsel for the Reinsurance Association of America. Ms. Laws is responsible for establishing and advocating the RAA's public policy positions. Prior to coming to the RAA, Ms. Laws was a partner in the law firm of Chadbourne & Parke, concentrating on reinsurance matters.

She is a member of the AIDA Reinsurance & Insurance Arbitration Society law committee and the ABA's TIPS Federal Involvement in Insurance Regulation Modernization task force. Ms. Laws received her undergraduate degree from the College of William and Mary and her law degree from the University of Virginia.

Mr. Travis Plunkett is our third witness. He is the Legislative Director for the Consumer Federation of America. Mr. Plunkett's focus is primarily on financial services issues, including credit reporting, bankruptcy, credit counseling, consumer privacy and insurance.

Prior to the CFA, Mr. Plunkett served as the New York State Legislative Representative for the American Association of Retired Persons and the Associate Legislative Director of the New York Public Interest Research Group. He received his bachelor's degree from the University of Denver. Fellow Westerner. Welcome, Mr. Plunkett.

Our final witness is Mr. Alex Soto, President of the Independent Insurance Agents & Brokers of America. Mr. Soto is also the President of InSource, Inc. of Miami, Florida. Mr. Soto has held numerous positions at the IIABA prior to becoming President, including

Vice President, and the Chairman of the Communications Committee Branding task force.

Mr. Soto has served as the Chairman and State National Director of the Florida Association of Insurance Agents and the Vice Chairman of the Florida Residential Property and Casualty Joint Underwriting Association. He has also served as a member of the Governor's Commission on the Florida insurance crisis and the insurance fraud task force.

Mr. Soto earned a bachelor's degree in international affairs from Florida State University.

Thank you for being here. I extend to each of you my appreciation for your willingness to participate in the hearing. We look forward to your expert testimony on this important issue.

Because your written statements will be included in the record, I request that you limit your time to 5 minutes. You will note that you have a clock, the timer in front of you goes from green when—until you have 1 minute left; then it goes to yellow and then it turns red.

I don't want you to cut off your statement because we're actually not overwhelmed with Members here, but if you can just recognize that that time, 5-minute time frame, is helpful to us, we'd appreciate that, and I may tap the gavel. And certainly we will have a 5-minute questioning period for Members of the Committee, as well, and I will tap a pencil or gavel just to remind people the time is up and we will certainly accommodate further rounds of questioning if Members would like to do that.

Pursuant to the directive of the Chairman of the Judiciary Committee, I ask the witnesses to please stand and raise your right hand to take the oath.

[Witnesses sworn.]

Mr. CANNON. Let the record reflect that each of the witnesses answered in the affirmative. You may be seated.

And, Mr. Sinder, we'd be pleased to hear your testimony now.

TESTIMONY OF SCOTT A. SINDER, ESQUIRE, COUNCIL, COUNCIL OF INSURANCE AGENTS & BROKERS

Mr. SINDER. Thank you, Mr. Chairman. Thank you both for holding this hearing today and for affording me the opportunity to testify today. And I'd also like to thank Representative Wasserman Schultz, both for serving as the Ranking Member today and for being an original sponsor of what we believe is an incredibly important piece of legislation.

My comments will focus strictly on title I of the nonadmitted insurance portion of the legislation.

I am testifying today on behalf of the Council of Insurance Agents & Brokers. The council represents the top 1 percent of insurance agencies and brokerage firms of the United States, who collectively place over 90 percent of all commercial property and casualty insurance in this country which last year exceeded over $200 billion in placements. We are testifying in support of this legislation because it would clean up a very important area of cumbersome regulatory oversight.

The bill—title I of the bill does not deregulate the regulation of nonadmitted insurance; it simply imposes a coherent rule that says

that only one set of rules will govern any single transaction, and that set of rules would be the home State where the policyholder is based, where the company has its corporate headquarters.

Nonadmitted insurance, as you noted in your introductory remarks, Mr. Chairman, is insurance that's purchased primarily by companies for noncompulsory coverages. It's only in areas where the State does not require companies or individuals to have insurance coverage. So, for example, worker's compensation, which is an area where States require coverage, is not eligible for primary surplus lines coverage. And the primary insurance covers the corporate treasury, doesn't cover the property; the property is just the trigger on when a claim will be paid out.

But the real beneficiary of that is not a consumer, is not a claimant; it's the company itself and its corporate treasury, which otherwise would be solely responsible for covering that loss.

There are five primary areas of surplus lines regulation among the States: the premium tax regulation; there is access to the market, when are you able as a consumer, as a corporate consumer, to access the surplus lines coverage; with what carriers you may seek to place the surplus lines coverage; licensing requirements; and there are other filing and disclosure requirements. Essentially, all 55 U.S. jurisdictions have a common set of areas in which they regulate, and they all regulate in these five areas.

The rules themselves in a substantive basis also do not differ in any substantive way. The difference is in the details, and let me give you an example. There is a disclosure that most States require you to give that says that this insurance is being placed with a nonadmitted carrier and that coverage is not therefore placed in the guaranty fund, and insured by the guaranty fund at the State.

Almost every State has the identical disclosure. Almost every State requires you to separately provide that disclosure on the very first page of the policy. Well, if you're placing a coverage that covers risks in 55 States, that requires 55 disclosures. It's impossible to place all of those on the first page unless that page is very, very long. And the House Financial Services Committee, when we testified, I had a stack of documents next to me that was this high that represented the tax filings for each of the States in which there was a risk that was insured, that was covered by that one single policy.

These are incredibly onerous burdens. It's not a burden to pay the tax, it's not a burden to give the disclosure, it's a burden to make the filings 55 times, to give 55 disclosures.

The underlying intent of the legislation and what it actually does is, it dictates that only a single set of rules apply and that single set of rules are the rules of the State in which the policyholder maintains its principal place of business. There are some other provisions there intended to assist the States in disseminating the premium tax revenue so that it encourages the States, for example, to adopt an interstate compact so that after the policyholder pays through the broker their premium tax to the policyholder State of residence. The States would then, behind that, share that premium tax revenue as they deem appropriate. But it would place the burden of making that final calculation and putting that mechanism in place on the States and not on the brokers of the policyholders.

By doing these things you will remove incredible administrative burdens that apply when you try to access the surplus lines market, and in doing so, you will enable brokers and commercial policyholders to try to bridge the gap in the areas in which you have the greatest efficiencies and coverage right now, and those are the areas of catastrophic exposures that Representative Wasserman Schultz noted in her introductory comments.

Even the National Association of Insurance Commissioners, in their testimony before the House Financial Services Committee in June of 2005, noted that this was an area in which Federal involvement was necessary and welcome. Commissioner Diane Koken, who at the time was the President of the NAIC and was the Commissioner from the State of Pennsylvania, Commonwealth of Pennsylvania noted as follows, and I am quoting her testimony:

"Federal legislation may be needed at some point to resolve conflicting State laws regulating multistate transactions. The area where this will most likely be necessary is surplus lines premium tax allocation. Federal legislation might also be one option to consider to enable multistate property risks to access surplus lines coverage in their home States under a single policy, subject to a single set of requirements."

That's exactly what title I does. It allows multistate placements to be governed by a single set of rules. Those in the policyholder's own State, it doesn't deregulate in any way. Business insurance is also noted that this is exactly the types of reforms that the Congress should be seeking to implement to help moderize and rationalize State insurance regulation and all of the stakeholders in this debate, the surplus lines cares, the brokers, and even the customers, as you noted, through RIMS, are very much supportive of title I of the legislation.

With that, Mr. Chairman, I would be happy to answer your questions at the conclusion of others' remarks.

Mr. CANNON. Thank you, Mr. Sinder. I note that the green light is still on. That is a rare occurrence in this business.

Mr. SINDER. Mr. Chairman, the clock started late, and I didn't feel it was appropriate for me to take advantage of that.

Mr. CANNON. We'll still give you credit.

Mr. SINDER. Thank you, sir.

[The prepared statement of Mr. Sinder follows:]

PREPARED STATEMENT OF SCOTT A. SINDER

Good morning, Chairman Cannon, Ranking Member Watt and members of the Subcommittee. Thank you for the opportunity to testify before you today on behalf of the Council of Insurance Agents and Brokers (The Council) and thanks to Representative Wasserman-Schultz for being an original sponsor of the Nonadmitted and Reinsurance Reform Act of 2006 (the Reform Act). This Act was approved unanimously and on a bipartisan basis by the House Financial Services Committee in July. We greatly appreciate the Judiciary Committee's review of its provisions, and hope that you will agree that it is a balanced and important reform, worthy of enactment by the House this year. Commercial insurance regulatory modernization is essential if we are to have a dynamic commercial insurance marketplace that addresses the needs of commercial insureds for the 21st century. The Council believes the proposed legislation constitutes a significant step toward that end and supports it wholeheartedly. We were greatly encouraged by the adoption of the legislation by the House Financial Services Committee, and look forward to working with you as you consider the proposal.

The Council represents the nation's largest, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place more than 80 percent—well over $90 billion—of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

My testimony today will focus on insurance sold by non-admitted insurance carriers, which encompasses "surplus lines" products placed through brokers and "independently procured insurance" in which the coverage is purchased directly by the insured without the aid of a broker. I will explain what these types of insurance are, describing the Byzantine State regulatory requirements that currently burden the surplus lines marketplace, and I will explain that the Reform Act will address those issues primarily by dictating that only an insured's home State's laws apply to such a placement, hugely benefiting surplus lines consumers, the insurance industry and the insurance marketplace as a whole, without sacrificing one iota of consumer protection.

INTRODUCTION

The members of the Council commend you for holding this hearing and considering this important legislation. Broad-based insurance regulatory reform is critical for the long-term health of the industry and for maintaining a strong, vibrant insurance sector for the benefit of policyholders. Surplus lines and reinsurance are essential elements of the insurance marketplace and we support efforts to initiate insurance regulatory modernization by focusing on these areas.

Although the State insurance regulators, through the National Association of Insurance Commissioners (NAIC), have attempted to institute regulatory reforms in surplus lines and other areas of insurance without federal involvement, the reality is that today's marketplace demands far more dramatic action than the States alone are able to provide. The pace of financial services convergence and globalization are far outstripping the pace of reform efforts by State regulators and legislatures. Competition and efficiency in the insurance industry lags behind other financial services sectors due to the regulatory inefficiencies and inconsistencies in the State insurance regulatory system, inefficiencies and inconsistencies that must be addressed if the insurance sector is going to be able to keep up with the pace of change in the rapidly-evolving global marketplace and thereby expand the insurance marketplace for the benefit of insurers, producers and consumers.

The Council regards itself as a pioneer within our industry with respect to regulatory modernization, though reform is a frustratingly long process. We formed our first internal committee to address the problems of interstate insurance producer licensing more than 60 years ago. Our efforts were finally rewarded, thanks to the leadership of this committee, with the enactment of the NARAB provisions of the Gramm-Leach-Bliley Act a few years ago—a first step on the road to insurance regulatory reform. The Reform Act is the next step on the road to modernization.

I want to emphasize at the outset that we are not advocating de-regulation of the non admitted insurance marketplace or any sort of reduction in consumer protections. What we are advocating—as we did with NARAB and producer licensing reform—is streamlining the current burdensome system of regulation, thereby doing away with the overlapping, conflicting rules that inhibit the non admitted marketplace and harm consumers. We believe that consolidating regulatory oversight into a single State—the insured's home State—makes eminent good sense, as opposed to the current system in which 55 jurisdictions, some with only remote connections to the transaction, dictate how—and whether—a transaction is completed. The long-term effects of such reform on the marketplace will ultimately benefit the consumer. Easing regulatory burdens—without sacrificing protections—will increase surplus lines insurers' capacity and improve availability of coverage for hard to insure risks such as national catastrophes and terrorism.

I. "NON ADMITTED" INSURANCE PROVIDES AN ALTERNATIVE TO THE TRADITIONAL INSURANCE MARKETPLACE BUT CURRENT REGULATORY REQUIREMENTS ARE PREVENTING THIS MARKETPLACE FROM FULLY REALIZING ITS POTENTIAL.

Non admitted insurance provides coverage for unique, unusual or very large risks for which insurance is unavailable in the admitted market. A surplus lines product

is an insurance product sold by an insurance company that is not admitted to do business in the State in which the risk insured under the policy is located. In essence, the insured goes to wherever the insurance company is located to purchase the coverage. The insurer may be in another State, or it may be in the United Kingdom, Bermuda or elsewhere. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers. In short, "surplus lines" are: (1) insurance products sold by insurance carriers that are not admitted (or licensed) to do business in a State, (2) to sophisticated commercial policyholders located in that State, (3) for insurance coverages that are not available from insurers admitted (or licensed) to do business in that State.

Although surplus lines is considered to be "unregulated," in reality the surplus lines marketplace is subject to extensive State statutory and regulatory requirements that impede the effectiveness of the market and increase costs to surplus lines consumers. As described more fully below, updating these regulations and laws and encouraging use of alternative insurance markets would help to increase options and decrease costs for insurance consumers.

Surplus lines insurance is universally recognized as an important component of the commercial property and casualty insurance marketplace in all States, and commercial property and casualty business is done increasingly through the surplus lines marketplace. Surplus lines products tend to be more efficient and a better fit for commercial coverages because they can be tailored to the specific risk profiles of insured with specialized needs. This is particularly true during hard markets, like the one we have experienced for the last several years, in which high premium rates for property and casualty insurance posed serious problems for many mid-sized and larger commercial firms. Hard markets cause availability to decrease and the cost of coverage to increase. During these periods, insureds—notably sophisticated commercial insureds—are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage options and hold down costs. Surplus lines insurance is just such an alternative.

Although the purchase of surplus lines insurance is perfectly legal in all States, the regulatory structure governing such coverage is a morass. When surplus lines activity is limited to a single State, regulatory issues are minimal. When activity encompasses multiple States, however, full regulatory compliance is difficult, if not impossible. And I should note that multi-State surplus lines policies are the norm rather than the exception because surplus lines coverage is uniquely able to address the needs of insureds seeking coverage in more than one State. Thus, the difficulty of complying with the inconsistent, sometimes conflicting requirements of multiple State laws is a real problem. Simply keeping track of all the requirements can be a Herculean task. For example: Maryland and the District of Columbia require a monthly "declaration" of surplus lines business placed, but only require payment of premium taxes on a semi-annual basis; Virginia, in contrast, requires that a declaration be filed and taxes be paid quarterly; New Jersey has 36 pages of instructions for surplus lines filings, including a page discussing how to number the filings and a warning not to file a page out of sequence because that would cause a rejection of the filing and could result in a late filing.

As a general matter, State surplus lines regulation falls into five categories: (1) taxation; (2) declinations; (3) insurer eligibility; (4) regulatory filings; and (5) producer licensing and related issues.

1. Taxes: States have inconsistent and sometimes conflicting approaches regarding the allocation of premium taxes, which can lead to double taxation and confusion when a surplus lines policy involves multi-State risks.

- Single situs approach—100% of the premium tax is paid to the insured's State of domicile or headquarters State. This approach is imposed by some States regardless of what percentage of the premium is associated with risks insured in the State. Virginia, for example, utilizes this rule.
- Multi-State approach—Premium tax is paid to multiple States utilizing some method of allocation and apportionment based upon the location of the risk(s). Because there is no coordination among the States on allocation and apportionment, determination of the amount of tax owed to each State is left to brokers and insureds. If a policy covers property insured in a single situs State and in an apportionment State, double taxation also is unavoidable. A majority of the States utilize this basic rule but the manner in which it is implemented (including the allocation formula) can vary wildly.
- No clear requirement—Nearly a dozen States that impose surplus lines premium taxes do not have statutory or regulatory provisions indicating the State's tax allocation method, leaving it up to the insured and the insured's

broker to determine how to comply with the State law. In such States, determination as to whether any tax should be paid and whether the allocation of any such tax is permissible and appropriate is often based on informal guidance from State insurance department staff.

In addition to the near-impossibility of determining the correct allocation for surplus lines premium tax in a way that does not risk paying too much or too little tax, the differences among the States with respect to tax rates, tax exemptions, taxing authorities, and the timing of tax payments impose huge burdens on surplus lines brokers (who are responsible for paying the taxes if they are involved in the placement) and on commercial consumers, who must navigate these requirements on their own for placements that do not involve a broker and who ultimately bear the costs of not only the tax but the administrative costs of compliance in any event.

For example, State surplus lines premium tax rates range from about 1% to about 6%. In one State, Kentucky, surplus lines taxes are levied not at the State level but at the municipality level. Aon, a member of the Council, reports that in order to properly rate taxes in Kentucky, they have to access electronic maps to determine the city and county in which a risk is located. There are hundreds of cities and counties in the State. Some counties charge a tax in lieu of the city tax, some charge it in addition to the city tax, some charge the difference between the city and county taxes, and some do not charge a city or county tax.

The due dates for premium taxes vary even more widely across the States. Surplus lines premium taxes are due:

- annually on a date certain in some States; the dates vary from State to State, but include: January 1, January 31, February 15, March 1, March 15, April 1 and April 16;
- semi-annually in some States; again the dates vary, but include: February 1 and August 1, February 15 and August 15, and March 1 and September 1;
- quarterly in some States (generally coinciding with the standard fiscal quarters);
- monthly in some States; and
- 60 days after the transaction in some States.

The States also differ with respect to what is subject to the tax, what is exempt from the tax, whether governmental entities are taxed, and whether brokers' fees are taxed as part of or separately from the premium tax (if they are taxed at all). As you can see, determining the proper surplus lines tax payment for the placement of a multi-State policy is a daunting task.

2. Declinations: Most States require that an attempt be made to place coverage with an admitted insurer before turning to the surplus lines market. Some States specifically require that one or more licensed insurers decline coverage of a risk before the risk can be placed in the surplus lines market. If it is determined that a portion of the risk is available in the admitted market, many States require that the admitted market be used for that portion of the risk.

State declination requirements are inconsistent and conflicting, however, and the methods of proving declinations vary tremendously—from specific requirements of signed affidavits to vague demonstrations of "diligent efforts." For example, Ohio requires 5 declinations, but does not require the filing of proof of the declinations. New Mexico requires 4 declinations and submission to the insurance department of a signed, sworn affidavit. Hawaii does not require declinations but prohibits placement of coverage in the surplus lines market if coverage is available in the admitted market. Further, Hawaii does not require filing of diligent search results, but requires brokers to make such information available to inspection without notice by the State insurance regulator. In California, prima facie evidence of a diligent search is established if the affidavit States that three admitted insurers that write the particular line of insurance declined the risk. In Alabama, the requirement is much more vague. The broker is required only to demonstrate "a diligent effort" but no guidance is provided suggesting what constitutes such an effort. In Connecticut, the broker must prove that only the excess over the amount procurable from authorized insurers was placed in the surplus lines market.

3. Insurer Eligibility: Most States require that a surplus lines insurer be deemed "eligible" by meeting certain financial criteria or having been designated as "eligible" on a State-maintained list. Although a majority of the States maintain eligibility lists (also called "white lists"), in many of the remaining States the surplus lines broker is held responsible for determining if the non-admitted insurer meets the State's eligibility criteria. In addition, although the NAIC maintains a list of eligible alien (non-U.S.) surplus lines insurers that is referenced by four States, this

does not seem to have any bearing on the uniformity of the eligible lists in the remaining States. As one would expect, as a result of differing eligibility criteria from State to State—and changes in individual States from year to year—the insurers eligible to provide surplus lines coverage varies from State to State. This can make it exceedingly difficult to locate a surplus lines insurer that is "eligible" in all States in which placement of a multi-State policy is sought.

The flip side of insurer eligibility is also an issue: that is, when multi-State surplus lines coverage is placed with an insurer that is an admitted (not surplus lines) insurer licensed in one of the States in which part of the risk is located. This is problematic because surplus lines insurance cannot be placed with a licensed insurer. In these situations, more than one policy will have to be used, or the insured will have to use a different surplus lines carrier—one that is not admitted, but "eligible" in all States in which the covered risks are located.

4. Filings: Most States require one or more filings to be made with the State insurance department in connection with surplus lines placements. These may include filings of surplus lines insurer annual statements, filings regarding diligent searches/declinations, filings detailing surplus lines transactions, and filings of actual policies and other informational materials. Some States that do not require the filing of supporting documentation require brokers to maintain such information and make it available for inspection by the regulator.

Like other surplus lines requirements, State filing rules vary widely. Some States require signed, sworn affidavits detailing diligent search compliance; some require such affidavits to be on legal sized paper, others do not; some States require electronic filings, others require paper; some States have specific forms that must be used, others do not; some States require the filing of supporting documentation, some do not—although some of those States place the burden on the broker, who is required to store the information in case regulatory inspection is required. In addition, although most filings are required to be submitted to the State insurance regulator, in at least one State, Kentucky, municipalities also require submission of surplus lines materials. There are hundreds of cities and counties in the State and each requires a separate quarterly and annual report by the licensee. As with the tax situation, this creates a terrible burden on surplus lines insurers and brokers, and unnecessarily increases consumer costs.

Depending on the State in question, filings can be required annually, quarterly, monthly or a combination thereof. For example, several States require the filing of surplus lines information in the month following the transaction in question: Colorado requires such filings by the 15th of the month; and the District of Columbia by the 10th. Other States peg the filing date to the date of the transaction or the effective date of the policy: Florida requires filing within 21 days of a transaction; Idaho within 30 days; Kansas within 120 days; Missouri requires filing within 30 days from the policy effective date and New York 15 days from the effective date; Illinois and Michigan require semi-annual filings of surplus lines transactions. Although Illinois does not require filing of affidavits, carriers must maintain records of at least three declinations from admitted companies for each risk placed in the surplus lines market. Some States have different deadlines for different filings. Louisiana, for example, requires quarterly filings of reports of all surplus lines business transacted, and "diligent search" affidavits within 30 days of policy placement. North Dakota, in contrast, requires a single annual filing of all surplus lines transactions, and allows 60 days for the filing of "diligent search" affidavits.

In addition, some States treat "incidental exposures"—generally relatively small surplus lines coverages—differently from more substantial coverages with respect to filing requirements. States have differing definitions of what constitutes incidental exposures and who has to make required filings for such an exposure: some States require the broker to make the filings; others the insured; and some require no filings at all for incidental exposures.

5. Producer Licensing and Related Issues: In addition to the substantial issues outlined above, there are other vexing regulatory issues facing the surplus lines marketplace:

- Producer Licensing: All States require resident and non-resident surplus lines producers to be licensed, and all States have reciprocal processes in place for non-resident licensure. Nevertheless, there remain significant differences among some States with respect to producer licensing that can delay the licensure process, particularly for non-residents. For example, most States require that an individual applying for a surplus lines broker license be a licensed property and casualty producer. The States vary, however, as to how long the applicant must have held the underlying producer license. In addition, some, but not all, States exempt from licensure producers placing multi-

State coverage where part of the risk is located in the insured's home State. In States without such an exemption, the laws require a producer to be licensed even for such incidental risks.

- Sophisticated Commercial Policyholders: Some States exempt "industrial insureds" from the diligent search, disclosure, and/or filing requirements. The definition varies among the States, but generally industrial insureds are analogous to the concept of sophisticated commercial insureds. They are required to have a full time risk manager, minimum premium requirements for selected lines of coverage, and a minimum number of employees. If an insured meets a State's criteria, the insured's surplus lines transaction is exempt from the surplus lines requirements, as provided for by the State.
- Automatic Export: A number of States allow certain risks to be placed directly in the surplus lines market. This is called "automatic export" because no diligent search is required before the risk is exported from the admitted market to the surplus lines market. As with every other surplus lines requirement, however, the States are not uniform in their designation of the risks eligible for automatic export.
- Courtesy Filings: A courtesy filing is the payment of surplus lines tax in a State by a surplus lines broker who was not involved in the original procurement of the policy. Courtesy filings are helpful when a broker places a multi-State filing that covers an incidental risk in a State in which the broker is not licensed. The problem is that most States either prohibit courtesy filings or are silent as to whether they will be accepted. This uncertainty essentially requires surplus lines producers to be licensed even in States where they would otherwise be exempt.

II. CONGRESSIONAL ACTION IS NEEDED TO ADDRESS THE UNNECESSARILY BURDENSOME AND OVERLAPPING STATE REGULATORY REQUIREMENTS IMPOSED ON THE SURPLUS LINES MARKETPLACE. THE REFORM ACT ACHIEVES THAT GOAL WITHOUT IN ANY WAY DIMINISHING CONSUMER PROTECTIONS OR REGULATORY EFFECTIVENESS.

The current surplus lines regulatory structure is not working. The overlapping, redundant, sometimes inconsistent State regulatory requirements described above fail to recognize current market realities—the great majority of surplus lines policies are placed on a multi-State basis and purchased by sophisticated commercial insureds who have unique risks that are not readily covered in the admitted market. The regulatory roadblocks erected by some States do nothing to improve the availability or affordability of insurance, nor do they protect surplus lines consumers. Indeed, we believe the current system causes significant disruptions in the surplus lines marketplace and increases costs for consumers.

The proposed Reform Act would fix the system. The legislation would streamline regulation and ease regulatory burdens, but without sacrificing consumer protections or a financially sound surplus lines marketplace, which is the most important consumer protection of all. The proposed legislation would provide an effective resolution to the current regulatory morass by focusing on the home State of the insured: all premium taxes would be payable to the insured's home State and surplus lines insurance transactions would be governed by the rules of the insured's home State.

This home State focus accomplishes several things:

- Home State regulation ensures that the insured is protected by the laws of its home State and the regulator with the greatest interest in its welfare. It is common sense to assume that a regulator will spend more time and effort on the needs of in-State constituents rather than non-residents with little or no stake in the State or its economy.
- Home State regulation is logical because the risks covered in the non-admitted market are generally commercial lines and are not compulsory. We are not talking about auto or homeowners or individual life coverage. These are unique risks that the insured is not required to protect with insurance but chooses to do so to protect the corporate treasury. The corporate treasury, in turn, is not located in the multiple States where the insured has risks, but in the State in which the insured itself is located—generally its state of domicile.
- Home State regulation completely does away with the inconsistent, redundant, burdensome obligations that the current system imposes in connection with multi-State placements. All the regulatory issues described above—taxes, filings, diligent searches, insurer eligibility requirements, producer li-

censing and more—will be governed by the rules of a single State rather than being subject to multiple State rules.

On one level, the effect of this change is significant—it will eliminate mountains of red-tape and administrative costs, ultimately saving consumers time and money, and expanding the availability of coverage for unusual or extreme risks such as natural catastrophes and terrorism. On another level, however, the change will be minimal. The Reform Act does not alter the basic elements of State surplus lines regulation. Indeed, all of the substantive provisions in the proposed legislation can be found in current State laws and regulations. The beauty of the proposal is that it enables surplus lines producers to look to a single standard in a single State for each transaction. Although the standard may differ from transaction to transaction depending upon the home State of the insured, each individual transaction will have a single standard, rather than being subject to the standards of 55 different jurisdictions. Clearly, this will make multi-State compliance significantly less daunting.

The Reform Act would fix the current tax allocation problems by establishing a clear requirement that all surplus lines premium taxes be paid to the insured's home State. Surplus lines producers would pay the full amount of premium tax owed on an insurance transaction to the insured's home State. In addition to the tax, the home State could require the filing of an allocation report denoting the location of the covered risks. The States are then free to allocate the premium tax among themselves as they so determine. The contrast in approaches—from the convoluted, burdensome approach of the States to the simple straightforward approach in the Reform Act could hardly be greater.

Finally, the exemption for sophisticated commercial policyholders is a victory for common sense. The State regulators, in many of their model rules and regulations, recognize that streamlined processes make sense for sophisticated commercial policyholders, who have a greater understanding of their needs and the insurance marketplace than individual consumers. In addition, sophisticated commercial policyholders are more likely to have unique or large risks for which surplus lines coverage is necessary. For these reasons, it only makes sense to allow such policyholders to access the surplus lines market without jumping through all the regulatory hoops that are currently imposed by some States.

The need for surplus lines regulatory reform is widely agreed upon by all stakeholder, and the Reform Act enjoys broad-based support from consumers (RIMS???), the insurance industry, and many Members of Congress, as evidenced by the House Financial Services Committee's unanimous passage of the bill in July. The bill has seen no opposition. Indeed, the State insurance regulators have worked with congressional staff to address technical issues, but did not object substantively to the proposal.

CONCLUSION

In closing, I would once again like to thank you for taking on this important, if unglamorous, issue. As my testimony has demonstrated, reform of the surplus lines insurance regulatory system is badly needed to maintain a competitive marketplace and, more importantly, to enable insurers and producers to provide insurance consumers with the coverages they need to protect themselves and their businesses from the risks inherent in today's world. The passage of the Act was unanimous and bipartisan in the House Financial Services Committee, and we look forward to House passage very soon. As I said at the outset, the Reform Act will get the job done and the Council looks forward to working with you to get it enacted into law.

Mr. CANNON. Ms. Laws.

TESTIMONY OF TRACEY LAWS, ESQUIRE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, REINSURANCE ASSOCIATION OF AMERICA

Ms. LAWS. Good morning. I am pleased to testify today on behalf of the RAA in support of H.R. 5637. My testimony will highlight the key provisions of the legislation that help to modernize and make reinsurance regulation more efficient, but first I will briefly discuss the role that reinsurance plays in the marketplace and how reinsurance is currently regulated.

Reinsurance is a transaction, as you noted, by which the reinsurer indemnifies, for a premium, the insurer for all or part of the

loss that the insurer may sustain under an insurance policy. Described as "insurance for insurance companies," reinsurance provides reimbursement for the insurer for losses that are covered by a reinsurance agreement.

Reinsurance agreements are between sophisticated parties. There is no consumer element to the reinsurance transaction. Reinsurance is very much a global business; encouraging the participation of reinsurers worldwide is essential to providing much-needed capacity in the United States.

The global reinsurance industry has significantly responded to virtually every major U.S. catastrophe over the past century. By way of example, it is expected that 60 percent of the losses from the 2005 hurricanes will be borne by reinsurers worldwide.

Reinsurance and U.S.-based reinsurers are regulated by the States. The States utilize two methods of regulation, direct and indirect. Direct regulation is imposed on reinsurers that ought to be licensed in a U.S. State. Reinsurers that are licensed in at least one State are subject to the full spectrum of laws and regulations to which a primary insurer is subject, including regulation for financial reporting and solvency.

The exception to this general rule is rates and contracts. Because reinsurance transactions involve sophisticated parties, there is no regulation of rates or, for the most part, the reinsurance agreement.

There is also indirect regulation of the transactions where a State's credit for reinsurance laws. Credit for reinsurance is the cornerstone of reinsurance regulation. If an insurer complies with its domiciliary State's credit for reinsurance laws, it may reflect the effect of the reinsurance transaction as an asset or as a reduction in its liabilities on its balance sheet.

H.R. 5637 helps to modernize reinsurance regulation in several ways. First, section 201 eliminates the extra territorial application of State laws. As a result of the current 50-State system, significant differences have emerged among the States with respect to reinsurance regulatory requirements.

The NAIC and State regulators are to be applauded for their efforts toward greater uniformity by the adoption of model laws and regulations and the creation of a system of accreditation for States to meet minimum standards of regulation. Unfortunately, this has not prevented certain States from pursuing varying and sometimes inconsistent regulatory approaches to reinsurance. This has resulted in approximately 14 States applying the laws on an extraterritorial basis. This means that these States apply their laws to not only insurers that are some domiciled in their State, but also to insurers that are domiciled elsewhere but licensed in that State. This is the case even if the reinsurance contract at issue does not cover any risks associated with that State.

Because reinsurance contracts are not written on a State-by-State basis and typically cover risks across many States, it is inefficient and unnecessary to require the contracting parties to meet the requirements of multiple jurisdictions for a single reinsurance transaction. Accordingly, the RAA strongly supports section 201 which preempts the extraterritorial application of State law and makes clear the types of laws that States cannot apply on an

extraterritorial basis, including laws involving critical elements of the reinsurance agreement.

Second, section 201 also streamlines the requirements pursuant to which an insurer may take credit for reinsurance. Currently, some States refuse to accept the credit for reinsurance determinations of an insurer's domiciliary regulator, causing the insurer's financial statement to vary from State to State. The act addresses this problem by requiring that no other State may deny credit for reinsurance that is recognized by the insurer's domiciliary regulator.

Third, section 202 provides that the reinsurer's State of domicile shall be solely responsible for regulating the reinsurer's solvency so long as the domiciliary State is an NAIC-accredited State or a State that has solvency regulations substantially similar to the requirements necessary for NAIC accreditation. This provision keeps strong insurance regulation intact, but eliminates duplicative regulation. The home State regulator will still be subject to the stringent NAIC accreditation standards, thereby protecting against a race to the bottom. The fundamental elements of reinsurance solvency regulation that are required by all States will remain in place.

Finally, H.R. 5637 ensures that all States have access to financial information of a U.S.-licensed reinsurer, but it relieves the reinsurer from filing supplemental and, at times, inconsistent financial information with various States. Redundant and burdensome regulation may affect where the reinsurance market chooses to deploy its capital and may increase the transaction costs for insurers and, ultimately, consumers.

The RAA applauds and supports the principles set forth in this act, which serve to streamline reinsurance regulation. Thank you.

Mr. CANNON. Thank you, Ms. Laws.

[The prepared statement of Ms. Laws follows:]

PREPARED STATEMENT OF TRACEY LAWS

My name is Tracey Laws and I am Senior Vice President and General Counsel of the Reinsurance Association of America. It is an honor to appear before you on behalf of the RAA. The RAA is a national trade association representing property and casualty organizations that specialize in reinsurance. The RAA membership is diverse, including U.S. companies and U.S. subsidiaries of foreign companies. Together, RAA members underwrite nearly 2/3 of the gross reinsurance coverage provided by U.S. property and casualty reinsurers and affiliates.

I am pleased to testify today on "H.R. 5637, legislation to streamline the regulation of nonadmitted insurance and reinsurance." The RAA supports the principles set forth in the legislation and will highlight the key provisions that will help modernize and make reinsurance regulation more efficient. My testimony will address: 1) the reinsurance role in the marketplace, 2) U.S. reinsurance regulation, 3) the extra-territorial application of state law provision, 4) the solvency regulation provision and 5) the credit for reinsurance provision.

REINSURANCE ROLE IN THE MARKETPLACE:

Reinsurance is a transaction by which one insurance company indemnifies, for a premium, another insurance company against all or part of the loss that it may sustain under its policies of insurance. The insurance company purchasing the reinsurance is known as the ceding insurer; the company selling reinsurance is known as the assuming insurer, or, more simply, the reinsurer. Described as insurance for insurance companies, reinsurance provides reimbursement to the ceding insurer for losses covered in the reinsurance agreement. Reinsurance is a contract between sophisticated parties; there is no consumer element to the reinsurance transaction. The fundamental objective of insurance, to spread risk so that no single entity finds

itself saddled with a financial burden beyond its ability to pay, is enhanced by reinsurance.

Reinsurance is a key component of the insurance marketplace, reducing volatility experienced by insurers, and improving insurers' financial performance and security. It is widely recognized that reinsurance performs at least four primary functions in the marketplace: to limit liability on specific risks; to stabilize loss experience; to protect against catastrophes; and to increase insurance capacity. Although considerably smaller than the U.S. insurance industry in premiums and capital, the global reinsurance industry has significantly responded to virtually every major U.S. catastrophe over the past century. For natural disasters typically one-third to one-half of the insured losses are passed on to reinsurers; in the events of September 11, 2001, two-thirds of the losses were absorbed by the global reinsurance industry.

U.S. REINSURANCE REGULATION—DIRECT AND INDIRECT

Like insurance, reinsurance and U.S. based reinsurers are regulated by the states not the Federal government. U.S. states employ two methods of reinsurance regulation, both direct and indirect regulation.

Direct regulation is imposed on those reinsurers that opt to be licensed in the U.S. Reinsurers licensed in at least one U.S. jurisdiction are subject to the full spectrum of laws and regulations to which a primary insurer is subject, including regulation for financial reporting and solvency. The exceptions to this general rule are rates and contracts. Because reinsurance is conducted between sophisticated parties of essentially equal bargaining power, regulators do not impose regulatory requirements relating to the rates that can be charged for reinsurance or, for the most part, the forms that can be used to evidence the contractual terms.

Recognizing that an insurance marketplace as large as that found in the U.S. is in need of a substantial amount of reinsurance capacity, U.S. regulators permit both U.S. and non-U.S. reinsurers to assume business on risks located in the U.S.

The states have developed a system of indirect regulation where the reinsurance transaction is regulated through the credit for reinsurance mechanism. Credit for reinsurance is the financial statement accounting effect given to a ceding insurer if cessions are ceded in accordance with prescribed state criteria. If the criteria are met, the ceding insurer may record as an asset or a reduction in insurance liabilities for the effect of the reinsurance transaction. The fundamental concept underlying the U.S. regulatory view is that a reinsurer must either be licensed in a U.S. state and subject to a full spectrum of reinsurance regulation or, in lieu of regulation, provide security to ensure the payment of the reinsurer's obligations to ceding insurers. Credit for reinsurance is the cornerstone of reinsurance regulation.

EXTRATERRITORIAL APPLICATION OF LAW

The RAA applauds Representatives Brown-Waite and Moore for addressing a key improvement in the efficiency of regulation of reinsurers: the elimination of the extraterritorial application of state laws. As a result of our 50-state system of regulation, significant differences have emerged among the states with respect to reinsurance regulatory requirements. The NAIC and state regulators are to be applauded for their efforts toward greater uniformity in the adoption of model laws and regulations and the creation of a system of accreditation for states to meet minimum standards for regulation. Unfortunately, this has not prevented states from pursuing varying and sometimes inconsistent regulatory approaches to reinsurance. One of the best examples of this phenomenon is the extraterritorial application of state laws.

Approximately 14 states apply their laws on an extraterritorial basis, meaning that the state law not only applies to insurers domiciled in that state but to insurers domiciled in other states if the extraterritorial state has granted a license to the insurer. For example, if a reinsurer domiciled in Ohio were entering into a contract with an insurance company domiciled in Massachusetts and either or both were licensed in other states, the reinsurer and insurer would abide by the Ohio and Massachusetts reinsurance requirements, but also to the reinsurance requirements of all other states that apply their laws on an extraterritorial basis. This is the case even if the contract between the reinsurer and ceding insurer does not have any risks associated with that particular state. Because reinsurance contracts are customarily written on a multi-state basis, it is inefficient and unnecessary to require the contracting parties to meet the legal regulatory and peculiarities of multiple jurisdictions for a single reinsurance transaction.

The RAA strongly supports the principle set forth in Title II, Section 201 that addresses these inefficiencies. This provision retains the ability of state insurance regulators to regulate their domestic insurers and reinsurers and the reinsurance

transactions of their domestic insurance companies. The Act simply preempts the extraterritorial application of state law and articulates the types of laws that states cannot apply on an extraterritorial basis, including critical elements of the reinsurance transaction, such as dispute resolution, governing law and requiring specific contract provisions. This provision will remove the burdensome and redundant requirements on the reinsurance transaction and will greatly improve efficiency.

CREDIT FOR REINSURANCE

Section 201 of the Act also assists in streamlining the requirements pursuant to which a ceding insurer may take credit for reinsurance on its financial statements. The NAIC'S accreditation system and model credit for reinsurance law seek to achieve uniformity in the ceding insurer's financial statement. However, some states refuse to accept the ceding insurer's domiciliary regulator's findings, causing a ceding insurer's financial statement to vary from state to state. The Act addresses this problem by requiring that no other state may deny credit for reinsurance recognized by the ceding insurer's domiciliary regulator.

REINSURANCE SOLVENCY REGULATION

The RAA supports the principles set forth in Title II, Section 202 that provide that the state of domicile of a reinsurer shall be solely responsible for regulating the financial solvency of the reinsurer if the state is an NAIC accredited state or a state that has financial solvency regulations substantially similar to the requirements necessary for NAIC accreditation. The financial integrity and solvency of a reinsurer is a key factor in determining whether a ceding insurer should receive credit for reinsurance on its' financial statement. Redundant and burdensome solvency regulation may affect where the reinsurance market deploys its capital and increase the transaction costs for insurers, and ultimately consumers. The Act eliminates duplicative solvency regulation of reinsurers by placing sole responsibility for solvency regulation on the reinsurers home state regulator. The Act protects against a "race to the bottom" for solvency regulation by requiring that the home state meet the accreditation standards set out by the NAIC.

Reinsurance is a global marketplace. Allowing the state of domicile of the reinsurance company to be the single regulator for solvency will help streamline reinsurance regulation significantly and will add to the value of a U.S. license. The home state of the reinsurer will still be subject to the stringent NAIC accreditation standards for solvency regulation. Because the NAIC requires that accreditation laws be "substantially similar," all accredited states have the same basic solvency protections and laws in place even if they may differ in some of the details.

The elements of reinsurance solvency regulation that all states require will stay in place under the proposed legislation and include: conservative statutory accounting rules, minimum reserve standards, annual actuarial opinion requirements, detailed financial reporting on the annual statement and quarterly statement blanks, annual certified public accounting audit reports, minimum capital requirements per the NAIC risk-based capital formula, state investment laws that provide minimum diversification and limits on investments, holding company laws for extraordinary dividends and intergroup transactions, and many other model laws that are required for accreditation. The NAIC accreditation system will still require the home state regulator to demonstrate that the state effectively enforces its solvency regulation standards. This includes how well the state regulator performs desk audits and examinations, whether they take timely action when needed and whether they have qualified staff and other review requirements.

Strong reinsurance solvency regulation is critical to the health of the insurance marketplace. This legislation keeps reinsurance solvency regulation intact. It does relieve the reinsurer from having to file supplemental and at times inconsistent financial information in as many as 50 states. Yet, it provides all states with access to financial information on a U.S. licensed reinsurer. This streamlined regulation will allow U.S. reinsurers to compete more effectively without compromising solvency regulation.

Mr. CANNON. Mr. Plunkett, you're recognized for 5 minutes.

TESTIMONY OF TRAVIS PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Good morning, Chairman Cannon and Representative Wasserman Schultz. My name is Travis Plunkett, and I am

the Legislative Director of the Consumer Federation of America. I applaud you for holding this hearing today.

CFA is very concerned about the effect of the Nonadmitted and Reinsurance Reform Act of 2006 on the insurance market and consumers. In an effort to make regulation of nonadmitted insurance lines and reinsurance more uniform, a goal that CFA supports if responsible regulation is not sacrificed, the bill would establish a feeble and complex oversight regime. It will likely provoke States to compete against each other to weaken oversight in some cases. It would also leave consumers who have been harmed by insured companies vulnerable in the event of a company's insolvency.

In addition, there are some vague, contradictory and incomplete requirements in the bill that do raise legal and, as I just mentioned, policy questions. I'll touch on four specific concerns.

First, contrary to the stated intent of legislation, section 107 appears to open the door to the increased sale of poorly regulated, nonadmitted personal lines of insurance like auto insurance to individual consumers, not just commercial insurance sold to sophisticated corporations.

Moreover, the bill does not appear to exclude nonadmitted personal lines of insurance from its provisions. If this bill fosters a sharp growth in underregulated nonadmitted insurance, it could seriously harm consumers who buy this insurance.

Second, great regulatory confusion and ineptitude would likely result when the State of domicile for an insured party regulates all parts of that entity's insurance transaction. For example, Michigan regulators overseeing General Motors' insurance transactions probably know very little about dealing with earthquake risk in California or hurricane risk in Florida in pricing insurance policies or in handling claims resulting from such weather events if GM's cars are damaged.

Moreover, since Michigan is a no-fault State for auto insurance regulators, they would likely know very little about how tort laws in other States and how pricing and claims should be handled. How can 50 regulators each become experts in the laws of 50 States? This is regulatory supercomplexity, not simplification.

Third, the bill is based—and this is a significant concern for us—it's based on an incorrect assumption that the domicile State of an insured party or a reinsurance company will provide adequate oversight; and there are a number of ways that the bill handcuffs States that would have a legitimate interest in regulating both.

For example, if residents have been harmed by clearly abusive insurance practices. Suppose a nonadmitted insurer for a company like GM acts in bad faith and refuses to pay legitimate claims regarding unsafe automobiles that harm drivers in other States. These States would have no ability to investigate or sanction that insurance company, while the State of Michigan, with limited resources and very little in-State impact, would have much less of an incentive to get to the bottom of the problem.

Moreover, a home-State regulator—this is the downside to home-State regulation. A home-State regulator has the greatest interest in pleasing a large insured party, or in the case of reinsurance, a large insurance company and employer based in that State. This could lead the regulator to lower insurance standards that protect

residents and consumers who use that company's products and services across the country.

The bill also specifically prohibits States from requiring that insurers seek coverage from admitted carriers before turning to non-admitted insurers. It is not in the public interest to foster the growth of a segment of the market that does not have to meet State standards unless admitted insurance is truly not available.

For example, guaranty associations in all States do not cover claims for surplus lines insurers from other States when an insurer or insured entity becomes insolvent. This may be a minor problem for the defunct policyholder and defunct insurer, but it's certainly a major problem for the people that the policyholder may have injured who are left without guaranty association protection.

Final concern—and I mention this in greater depth in our testimony—there's another incorrect assumption; and the investigations by New York Attorney General Eliot Spitzer show this to be true. Large sophisticated corporations were victimized by insurers and brokers through bid-rigging, kickbacks, hidden commissions and blatant conflicts of interests. So it's simply not true that large, sophisticated consumers don't need some of the protections that this law would do away with.

In closing, let me say this: It's very clear that the drafters of this proposal have not thoroughly considered the harmful effects the bill could have on the insurance market, those who buy products or services from companies that purchase surplus lines or reinsurance, or even on State revenues, not to mention certain legal concerns. The bill should require the execution of a thorough GAO study on all of these issues as opposed to the incomplete study mandated in section 106 before any of these provisions are enacted.

Thank you very much.

Mr. CANNON. Thank you, Mr. Plunkett.

[The prepared statement of Mr. Plunkett follows:]

PREPARED STATEMENT OF TRAVIS PLUNKETT

Consumer Federation of America
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Testimony of
Travis Plunkett, Legislative Director
Consumer Federation of America

Before

The U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

H.R. 5637, the Non-admitted and Reinsurance Reform Act of 2006

September 19, 2006

Good morning Chairman Cannon, Ranking Member Watt, and the members of the Committee. My name is Travis Plunkett and I am the Legislative Director of the Consumer Federation of America (CFA). CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

I appreciate the opportunity to testify before you on the Non-admitted and Reinsurance Reform Act of 2006 (H.R. 5637.) This is a proposal of great complexity that raises a number of significant legal questions that we urge the Subcommittee to examine carefully. In an effort to make regulation of non-admitted insurance lines and reinsurance more uniform, the bill would establish a feeble and complex oversight regime that will provoke states to compete against each other, to weaken oversight in some cases, and that could leave consumers who have been harmed by insured companies vulnerable in the event of a company's insolvency. CFA is very concerned about the effect of this bill on the insurance market and consumers.

Background

H.R. 5637 is a sharply scaled-back version of the State Modernization and Regulatory Transformation Act (SMART) discussion draft offered by Representatives Baker and Oxley last year. The initial SMART proposal would have preempted and eliminated state oversight of insurance in many important areas, such as the regulation of insurance rates, without establishing strong, uniform federal consumer protection standards. This bill, which was initially only one of 17 titles in the SMART Act, preempts states only in the regulation of surplus lines of insurance and reinsurance.

H.R. 5637 would provide for a method of collecting state premium taxes for surplus lines and allocating this income to the states. It would give deference to the regulations of the home state of the entity purchasing an insurance policy from a non-admitted insurer and in regulating surplus lines brokers. Further, the bill would adopt the model law developed by the National Association of Insurance Commissioners regarding eligibility requirements for surplus lines carriers on a national basis, preempting state laws. It allows large buyers of insurance to get surplus lines coverage without having to show, as most states require today, that a search of the licensed market was made and no coverage was found. The bill also requires the Government Accountability Office (GAO) to conduct a study of the non-admitted insurance market not later than 30 months after the Act takes effect.

Reinsurance would be regulated only by the home state of the ceding primary insurer. All other states would be prohibited from enforcing extra-territorial authority under their laws. Solvency regulation would be conducted by the state of domicile of the reinsurance company.

Taxes on surplus lines insurers are currently levied through licensed surplus lines brokers in each state, who keep track of the premiums they write per state, a much simpler system than that proposed in this bill. The regulation of surplus lines carriers occurs by requiring brokers to make a

meaningful attempt to get a licensed carrier for a client before seeking surplus lines coverage, as licensed carriers are regulated by each state. Customers of parties insured by licensed carriers are protected in the event of insolvency by the insured entity in each state through the existence of guarantee associations. Surplus lines carriers must submit data to each state that requests it to be included on that state's list of approved insurers.

Serious Policy and Legal Questions Surround the Preemption and Interstate Compact Provisions of H.R. 5637

CFA has not examined the Constitutional and legal basis of this proposal, but we urge this Subcommittee to ask some fundamental questions on this topic as you consider the bill. H.R. 5637 overrides state tax laws, allows only the state of domicile of an insured party to collect premium taxes, and says that it intends for the states to create a nationwide regulatory system of non-admitted insurers. Examples of harmful, vague, incomplete, or contradictory requirements in H.R. 5637 include the following:

- The definition of "home state" in section 107(3) of the bill appears to apply the provisions of this bill to non-admitted insurance sold to individual consumers, not just companies. A home state is defined to mean the state in which an insured entity or "individual" maintains a principal residence. This provision is contrary to the stated intent of the sponsors of the bill to apply it only to the purchase of commercial coverage by sophisticated corporations. If the bill allows the growth of poorly regulated non-admitted insurance – as it is intended to do – it could seriously harm consumers who buy "personal lines" of non-admitted insurance, such as automobile or homeowners insurance (for example, to protect a home from brush fires). According to the 2005 edition of "Best's Aggregates and Averages," almost $1 billion in non-admitted personal lines premium was sold in 2004. Moreover, the operating profit of these lines was more than twice that for property-casualty insurance overall. It is entirely realistic to assume that this bill could encourage increased sales of non-admitted insurance to individual consumers. CFA strongly urges this Subcommittee to closely examine this extremely troubling section.

- Section 101 (b)(1) prohibits any state, other than the home state of an insured party, from requiring premium tax payments for non-admitted insurers. This provision does not address the collection of state fees for such purposes as market conduct and financial examinations, or the collection of fines for violations of the law. However, Section 103 allows states to collect fees related to the licensing of a non-admitted insurer if that insurer participates in a national insurer producer database developed by the National Association of Insurers (NAIC). These two provisions appear contradictory in intent. Can states other than the state of domicile collect these common fees and fines, or not? If not, does Congress have the legal authority to prohibit the collection of fees for services rendered exclusively by the states?

- Section 101 (b)(4) states that "Congress intends that each State adopt a nationwide or uniform procedure, such as an interstate compact…" for the payment and allocation of

premium taxes. This extremely vague requirement, if it even is a requirement, raises some troubling questions. How does Congress intend for this system to work? What are the standards that Congress will require states to meet in the creation of this interstate system? How will Congress exercise oversight? Rather than obliquely requiring an interstate compact regarding the oversight of non-admitted insurers, the authors of this legislation should propose specific requirements to effectuate and implement such an interstate system and then seek input as to whether such a system meets Constitutional scrutiny.

The Spitzer Investigations Demonstrate that Large Buyers of Insurance (and their Customers) Need Basic Consumer Protections

Section 103(c) of H.R. 5637 reduces the already minimal state regulation of non-admitted insurance companies by forbidding any state other than the home state of an insured party from regulating non-admitted insurers that do business with that party. Section 105 "streamlines" the process of selling surplus lines insurance by permitting insured parties to procure surplus lines coverage without having to show, as most states require today, that a search of the licensed market was made and no coverage was found.

These two provisions assume that large buyers of insurance don't need protections that would normally be provided in an insurance transaction, such as protection from deceptive sales practices, unfair discrimination, and verification of legality of policy forms. The investigations and settlements pursued by New York Attorney General Eliot Spitzer refute this assumption. The nation was shocked when it learned that Attorney General Spitzer had uncovered remarkable levels of anti-competitive behavior involving the nation's largest insurance companies and brokers. The victims were the most sophisticated insurance consumers of all – major American corporations and other large buyers. Bid-rigging, kickbacks, hidden commissions, and blatant conflicts of interest were uncovered.

Attorney General Spitzer's findings are, unfortunately, a reflection of the deeply rooted anti-competitive culture that exists in the insurance industry. On the federal side, the antitrust exemption that exists in the McCarran-Ferguson Act (that is modeled by many states) has been the most potent enabler of anti-competitive practices in the insurance industry. Congress has also handcuffed the Federal Trade Commission in prosecuting, as well as even in investigating and studying, deceptive and anti-competitive practices by insurers and brokers. On the state side, insurance regulators have utterly failed to protect consumers and to properly regulate insurers and brokers in a number of key respects. Many of these regulators, for example, collaborated with insurance interests to deregulate commercial insurance transactions, which further hampered their ability to uncover and root out the type of practices uncovered by Attorney General Spitzer. Deregulation coupled with an antitrust exemption inevitably leads to disastrous results for consumers.

The Spitzer investigation reveals how easily sophisticated buyers of insurance can be duped by brokers and insurers boldly acting in concert, as they have become accustomed over the long history of insurance industry anticompetitive behavior. H.R. 5637 establishes a new regulatory regime that is, at best, complex and difficult to implement and, at worst, much less effective. It will create serious risks for large buyers of insurance and the consumers they serve. The customers of

these "sophisticated" companies and insured parties are put at great risk by the use of surplus lines carriers. If the insured party and the insurer become insolvent, state guarantee funds would not be available to help these consumers (see below).

Great Regulatory Confusion and Ineptitude Would Likely Result When the State of Domicile for an Insured Party Regulates All Parts of that Entity's Insurance Transaction

As an example of how confusing and ineffectual this regulatory regime would likely be, consider how the State of Michigan might regulate insurance contracts for General Motors (GM). Let's say that GM or another large company based in Michigan has purchased a commercial automobile policy for its cars on the West Coast and Gulf Coasts from non-admitted insurers. In all likelihood, Michigan regulators know very little about dealing with earthquake risk in California or hurricane risk in Florida in pricing insurance policies, or in handling claims resulting from such weather events if GM's cars are damaged. Michigan regulators probably also uninformed about how no-fault or other unique state laws should apply to a given claim. Since Michigan is a no-fault state for auto insurance, regulators there would likely know very little about tort laws in other states and how pricing and claims should be handled. How can 50 regulators each become expert in the laws of all 50 states? This is regulatory super-complexity, not regulatory simplification. Today, each state applies its own laws to insurance transactions within its own borders. Regulators do not have to be experts about laws and insurance risk in 50 states.

H.R. 5637 includes a number of other regulatory complexities that could bring implementation of the law to a grinding halt. For example, to facilitate the proper allocation of state premium taxes, Section 101(c) gives states the authority to require brokers in other states to file tax allocation reports with that state. So, the State of Michigan could, in theory, require brokers that Michigan does not license in other states who have sold GM various surplus lines polices to file reports regarding taxes that are often adjusted after a contract is signed. As insurance contracts for large companies often cut across state lines, allocating tax revenues by state is very difficult. The collection of 50-state data regarding every transaction by every commercial party that purchases insurance in a particular state is a hopelessly complex process that is ripe for abuse and mismanagement, if not outright tax evasion

To make matters even more confusing, Section 102(b) appears to allow every state to license out-of-state brokers who do business with in-state companies. However, it is hard to fathom that any state other than those that are extremely large would have the resources to properly license and oversee such a large number of brokers.

H.R. 5637 Incorrectly Assumes that the Domiciled State of an Insured Party or Reinsurance Company Can Provide the Best Oversight

Section 102(c) would prohibit any state from regulating a non-admitted insurer in any way if the insurer is not domiciled in the state. Other states would be helpless to act even if their residents are harmed by clearly abusive insurance practices. Suppose a non-admitted insurer for a company like GM acts in bad faith and refuses to pay legitimate claims for unsafe automobiles that harmed drivers in Texas? The State of Texas would have no ability to investigate or sanction that insurance

company while the State of Michigan, with limited resources, would have much less of an incentive to get to the bottom of the problem.

Chairman Oxley of the Financial Services Committee has stated that "choice of law" provisions like this are desirable because the state of domicile has the greatest interest in protecting insured companies. Chairman Oxley seems to have forgotten about protecting consumers and customers of an insured company. If the State of Washington, for example, has the greatest interest in pleasing Microsoft, this could be to the detriment of its residents and consumers across the country.

Another "race to the bottom" would be incited by Section 105 (mentioned above.) By allowing large commercial insured parties to seek coverage from non-admitted insurers without even determining whether the same coverage is available from an admitted carrier, H.R. 5637 will undoubtedly spur the growth of poorly regulated surplus lines carriers. State regulators attempt to ensure that licensed insurers meet certain safety and soundness and consumer protection standards that surplus lines carriers often do not have to meet. This protects both the insured entity and those served or affected by the insured entity (see below.) It is not in the public interest to foster the growth of a segment of the market that does not have to meet state standards.

The bill also presents unique problems regarding the regulation of the reinsurance industry. Section 202(a) only allows the domiciled state of a reinsurance company to regulate that company's solvency. What if insured entities in the state of domicile are covered by only one percent of the reinsurance written by a particular company but entities in another state are covered by 75 percent of the reinsurance? Why does it make policy sense to exclude the state whose citizens and businesses have the most to lose if a reinsurance company is not properly capitalized?

Moreover, allowing a domiciliary state to essentially act as a national regulator promotes forum shopping by insurers, in which companies move their official domicile from state to state to secure the most favorable regulatory environment. This spurs states to "compete" in offering the weakest oversight. The state of domicile is often under the greatest political and economic pressure not to act to end harmful business practices by a powerful in-state insurer. When CFA's Insurance Director Bob Hunter was Insurance Commissioner of Texas, he had to investigate an insolvent insurer in another state because the commissioner of that state refused to do so. Several directors of that insurer were former governors and insurance commissioners of the domiciliary state.

The Bill would Guarantee that Consumers would be Harmed in the Event that a Surplus Lines Insurer becomes Insolvent.

This is because the guaranty associations in all states do not cover claims for surplus lines insurers from other states. This may be a minor problem for the defunct policyholder and the defunct insurer, but it certainly is a problem for the people that the policyholder may have injured and are left with out guarantee association protection, such as victims of asbestos exposure.

In conclusion, let me say that the concerns that I have raised with H.R. 5637 make it very clear that the drafters of this proposal have not thought through the legal and constitutional

implications raised by the bill, not to mention the harmful effects that the bill could have on the insurance market, those who buy products or services from companies that purchase surplus lines insurance or reinsurance, or even state revenues. For example, according to the Committee Report on H.R. 5637, the Congressional Budget Office (CBO) has determined that the bill will increase federal revenues (and thus decrease state revenues) by $5 to $10 million dollars a year. The CBO also says that it is uncertain how much the unfunded mandates in the bill will cost the states, but it estimates that these costs won't exceed $64 million. The bill should require the execution of a thorough GAO study on all of these issues -- as opposed to the incomplete study mandated in Section 106 -- before any of these provisions are enacted. It makes no sense to put this proposal on the books until more careful analysis is conducted of the bill's impact.

Thank you for the opportunity to offer CFA's comments.

Mr. CANNON. Mr. Soto.

TESTIMONY OF ALEX SOTO, PRESIDENT, INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

Mr. SOTO. Thank you. Good morning, Chairman Cannon, and good morning, Congresswoman Wasserman Schultz. It's nice to see you again.

Indeed, my name is Alex Soto, and I am the President of the Independent Insurance Agents & Brokers of America. We are the largest and the oldest trade organization representing independent agents. We have over 300,000 agents, brokers and their employees in every State of the Nation, in every big city and every small town; and what makes us unique is, as independent agents, we are not employees of any single company, but rather we represent multiple companies, and through that methodology, we try to do the very best for our clients in selecting coverage for them.

How I earn my living is as an independent agent in south Florida. I am President of InSource Inc., which is indeed one of the largest privately held insurance agencies in south Florida. We have our main office in Miami, and we have an office in Broward County.

What we do is, we sell a broad array of insurance products to individuals, as well as commercial clients. And we transact business primarily in the State of Florida, but we also transact business—when our clients have locations in other States, we transact business in other States. And consequently, we do have a great deal of out-of-State licenses.

I personally hold licenses, nonresident licenses, in about 10 to 15 States and, collectively, the agents in my office hold more than 25 licenses. One of my partners has a surplus lines license, which allows us to provide coverage for unique and hard-to-place risk, predominantly in commercial lines. Congresswoman Wasserman Schultz was correct that, unfortunately, we are having to use this mechanism more in the State of Florida because of the crisis that we have in windstorm property coverage.

We also work very closely with a number of surplus lines brokers in order to expand and broaden our market access and better serve our clients—which is what we are all about.

The challenges of the current State-by-State system has already been mentioned. Each State regulation is different. Surplus lines licenses must be held in every State that you do business. Some States require—some States require due diligence steps, and other States do not. Some States require a paper trail; others, you can apply to them electronically. The surplus lines taxes vary from State to State and the allocation methodology, and the interpretation by them is quite confusing.

All of these spell out inefficiency, more cost and less time that we can take to serve our clients and advise them as to what they should secure in terms of coverage. The legislation before us solves many of the problems. Thus, our trade association, the "Big I," support H.R. 5637.

The legislation would make the insured home State, as was mentioned before, to be the source of regulation. For sophisticated consumers it waives the requirement of due diligence: The payment of

taxes to one location, and then, by compact, the different States organize themselves to divvy that up.

So we support the specific reforms of this bill RIMS supported, that are the users of this methodology predominantly. We also, more importantly, support the approach that the bill takes, which is basically legislation to preserve the State system of insurance regulation.

I happen to believe that regulation closer to home is the best regulation. The best role of the Federal Government, in our opinion, is pragmatic, pragmatic reform that utilizes targeted Federal action to improve State regulation.

It is our hope that the next step that is taken by the Congress is modernization and reformation of the producer and insurance company licensing.

Thank you, Mr. Chairman.

Mr. CANNON. Thank you Mr. Soto.

[The prepared statement of Mr. Soto follows:]

PREPARED STATEMENT OF ALEX SOTO

Good morning Chairman Cannon, Ranking Member Watt, and Members of the Subcommittee. My name is Alex Soto, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) and to provide my association's perspective on the surplus lines/reinsurance legislation that is the focus of this hearing. I am the current President of IIABA, and I am also President of InSource, which is a company that was formed from a merger of three of Miami's oldest insurance agencies. Through our practice specialties, InSource has had and continues to have a long-term and total commitment to our South Florida community.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance—property, casualty, life, health, employee benefit plans, and retirement products.

IIABA COMMENDS H.R. 5637 AS THE RIGHT APPROACH

Chairman Cannon and Ranking Member Watt, I want to thank you for your attention to this matter, which is important to members of the IIABA. I also want to commend the House Financial Services Committee for passing this legislation through a bipartisan voice vote. Special recognition should be extended to Congresswoman Ginny Brown-Waite of Florida, Congressman Dennis Moore of Kansas, and Capital Markets Subcommittee Chairman Richard Baker who drafted this legislation. We believe that overall the bill is the right approach to modernize insurance regulation, and we are happy to support it. We look forward to working with this Subcommittee and Committee during your review of the legislation.

In particular, this legislation preserves the state system of insurance regulation while achieving much-needed uniformity. Virtually every sector—insurers, producers, consumers and even regulators themselves—has voiced significant concerns with the inefficient patchwork of different laws and regulations that characterize the current regulatory system. Although we also believe that the current state-based insurance regulatory system is in need of greater efficiency and uniformity, IIABA opposes constructing a completely new regulatory scheme at the federal level through mandatory or optional federal regulation. A new, federal insurance regulatory system would dismantle the inherent strengths of state regulation, namely diversity, geographical uniqueness, innovation and responsiveness to consumers.

IIABA believes the best use of federal legislative authority is to help make the existing state system more efficient and uniform through a mix of national standards with state enforcement and uniformity achieved through both incentives and preemption of certain state laws. This approach offers the best solution because it will promote more uniform standards and streamlined procedures from state to state; protect consumers and enhance marketplace responsiveness; and emphasize that oversight can best be met by improving the state-based system. The result for

all stakeholders would be a more efficient, modern and workable system of state regulation.

The Nonadmitted and Reinsurance Reform Act of 2006 singles out two areas—surplus lines regulation and reinsurance supervision—where there is general consensus for early action. We support this step-by-step approach to achieve reform. While IIABA is eager also to have Congress address the need for uniformity and streamlining in producer licensing as well as other reform areas, we strongly support the general approach taken in H.R. 5637.

ROLE OF AGENTS & BROKERS IN THE NONADMITTED INSURANCE MARKET

Nonadmitted, or surplus lines, insurance provides coverage for unique or hard to place property and casualty risks when unavailable or unaffordable in the traditional, licensed or "admitted" insurance market. The role of independent insurance agents and brokers in the nonadmitted market is just as important as their role in the overall insurance market. Independent insurance agents and brokers invest substantial effort to identify policyholders' wants and needs; understand the complex terms of policies available; assess the products available and present choices to the consumer about coverage, price, service, and financial strength of carriers; and remain available to assist with any questions and changes as needed.

IIABA believes that continued state supervision of this market is necessary to ensure that the nonadmitted marketplace continues to function as the "safety-valve" for the overall insurance market for hard-to-place risks. Nevertheless, the current state-based regulatory scheme is burdened by inefficiencies that disrupt the non-admitted marketplace with respect to the allocation and remittance of premium taxes, licensing of nonresident surplus lines brokers, and duplicative regulation of the non-admitted market generally.

NEED FOR UNIFORMITY IN PREMIUM TAX ALLOCATION AND REMITTANCE

Premium tax allocation and remittance schedules vary significantly from state to state. Surplus lines brokers are responsible for determining which state's allocation formula governs a transaction involving a multi-state surplus lines risk. State surplus lines laws require that a licensed surplus lines agent or broker placing coverage remit taxes to the state on the portion of premium allocated to that state. State laws do not, however, contain mechanisms for the remittance of premium taxes to other states. Moreover, nonresident surplus lines agents and brokers have no guidance on which state surplus lines laws govern multi-state surplus lines transactions. As a result of the lack of a universally applicable allocation formula for multi-state risks and sufficient guidance on which state's laws govern a multi-state surplus lines transaction, surplus lines agents and brokers attempting to comply with lawful requirements of the various states often are caught between conflicting rules and claims on premium tax revenues. The confusion and conflicts result in inefficiencies and expenses which ultimately affect policyholders in addition to the producing agents and brokers.

IIABA supports the Nonadmitted Insurance and Reinsurance Reform Act of 2006 because it eliminates this confusion. Under the bill, a surplus licenses licensee (the broker accessing the nonadmitted market) need only remit premium taxes to the home state of the insured, and if requested, a report of the location and insured values of properties and risks by states covered under the policy being placed. The states then determine how the taxes will be allocated, either by compact or by other procedures developed by the states, and in each case using the allocation information provided by the surplus lines broker.

FIRST STEP IN UNIFORMITY IN PRODUCER LICENSING

Surplus lines agents and brokers engaging in transactions that involve multi-state risks currently must obtain and maintain general agent or broker licenses and surplus lines licenses in many if not every jurisdiction in which the exposures are located. Some states require that these agents and brokers obtain and maintain corporate licenses as well. This means that a surplus lines broker or agent could potentially be required to obtain and maintain up to 100 separate licenses in order to handle a single multi-state surplus lines transaction. Moreover, each state has different licensing requirements and renewal schedules. These duplicative licensing requirements cause administrative burdens which impede the ability of agents and brokers to effectively and efficiently service their customers' policies. Perhaps most importantly, these onerous licensing requirements create expenses which ultimately impact policyholders. The Nonadmitted Insurance and Reinsurance Reform Act alleviates the burdens of duplicative licensing requirements by relying on the insured's home state for licensing and encouraging states to participate in a national insur-

ance producer database without diminishing the quality and expertise of the surplus lines insurance distribution channel.

UNIFORMITY IN SURPLUS LINES REGULATION

Surplus lines agents and brokers must typically comply with the laws and regulations of multiple states with respect to coverage for multi-state risks. As a result of the lack of sufficient guidance on which state law governs a multi-state surplus lines placement, agents and brokers who have obtained nonresident surplus lines licenses find themselves attempting to comply with the surplus lines laws of every applicable state. These agents and brokers are subject to multiple tax filings, multiple diligent search requirements (which vary from state to state), multiple regulatory filings, and multiple information notices on the declarations page or policy, among other duplicative regulatory requirements.

The Nonadmitted Insurance and Reinsurance Reform Act effectively streamlines surplus lines regulation by making the insured's home state the source of regulation for individual surplus lines transactions. In addition, the Act streamlines access to the surplus lines market by waiving state due diligence requirements for the sophisticated commercial entities that constitute a significant portion of policyholders in this market.

The bill also has a second title that would, in much the same way as the nonadmitted insurance title, seek to reduce overlapping, multiple-state regulation of both reinsurer financial condition and credit-for-reinsurance on the balance sheets of ceding insurers. While, IIABA is less directly concerned with this title, except to the extent some of our members serve as brokers of outward reinsurance programs, we nevertheless note and applaud that this reinsurance title also seeks to retain and improve state regulation rather than create a federal regulator.

CONCLUSION

The IIABA supports the Nonadmitted and Reinsurance Reform Act of 2006. We appreciate the interest of this Committee in this issue and applaud the bipartisan actions of the House Financial Services in passage of the legislation. We urge this Subcommittee and Committee also to promptly act on this bill. IIABA believes that this legislation is an excellent example of a pragmatic reform approach that utilizes targeted, federal tools to improve the state-based regulatory system. We are also hopeful that this approach will be used in the near future to facilitate additional reforms in the state-based system of insurance regulation. Thank you again for the opportunity to testify.

Mr. CANNON. We're going to go to the Ranking Member to begin the questioning.

Ms. Wasserman Schultz.

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman.

Mr. Soto, thank you very much for joining us. And I am particularly pleased that the "Big I" is currently chaired by a Floridian.

You mention that you prefer regulation closer to home, and if you would, expand on that.

Mr. SOTO. Sure.

Ms. WASSERMAN SCHULTZ. That would be helpful.

Mr. SOTO. Well, my experience over the years has been that, indeed, regulation closer to home will be more nimble and better to react. Let me give you a couple of examples.

After Hurricane Andrew, a few insurance companies started nonrenewing and canceling policies of affected policyholders. We got ahold of our insurance commissioner, and he, within 24 hours, put a stop to that and basically said, until a home is repaired or you're fully compensated, you cannot nonrenew.

Where am I going to go with a home with no roof to try to place the insurance? Try to imagine with a Federal regulator, how long it would take to react would be absolutely awful.

We're having a serious property crisis right now in Florida, and our cabinet, our governor, organized themselves to create a resid-

ual market. Within 4 weeks we've gone from not having it to now we're beginning to get it.

The last comment I would make, in 1983 to '85, I was part of a group that came up to Washington with a goal of reforming flood insurance; and we quickly realized that the reform that they were looking for was just administrative reform because the thought process was that it would take an act of Congress to make any significant changes.

We recommended that—there is a huge gap in the Federal flood program, and that is the lack of business interruption and additional living expense. Nothing was enacted. Twenty-five years later we're finding the Katrina victims, many of them are going out of business because they have no business interruption or no additional living expenses.

So I think local regulation is better for my clients and for the people that I represent.

Ms. WASSERMAN SCHULTZ. Thank you. And since we're here, can you talk about what other steps you think need to be taken in addition to this? This will take us a few steps down the road, but what else could——

Mr. SOTO. Well, this I think will expand the marketplace. It's not a magic pill for the problems that the coastal areas have, but anything that expands the marketplace a little bit is good. When insurance companies compete for my clients' business, the client wins, coverage is better and premiums go down.

I happen to support what you mentioned earlier, the bill which is what we need ultimately, a Federal reinsurance program. Natural disasters are a national phenomenon, and we need to address that in order to shore up our coastal problem; and we have two ways to do it. Air Force One gets up in the air, and we start shoving FEMA money out the back; or we do it front end, logically, systemically, and people pay actuarially sound premiums for that.

Ms. WASSERMAN SCHULTZ. Mr. Chairman, I have just a couple more questions.

But, you know, I am someone who has prided myself, in 14 years in public office, on being somewhat of a consumer champion. And, you know, Mr. Plunkett has raised some concerns; and I am wondering if you could address those concerns. Because my understanding is that RIMS, which is the organization that essentially is the consumer representative of the companies that are interested in this type of insurance, is supportive of this legislation.

So if you could address some of the things that—items you have raised; and anyone else who wants to address those, as well.

Mr. SOTO. To a great extent, he's right, that there could be some situations where there is some abuse. I don't believe that you ought to take an entire system and stop the reformation of a system because there are going to be a few pockets of possible abuse.

The fact of the matter is that the ratio between commercial lines and personal lines on a national basis is about 33-to-1. In other words, it's a $33 billion industry of which $1 billion is personal lines.

So while he's right, you ought not to legislate on the basis of the exception being the cure.

Mr. SINDER. With all due respect to someone whom I very much respect, I do not think he's right, and I'd like to address it specifically.

Basically, there are two things that are interwoven in the critiques that were made. One is that the alternative to the nonadmitted marketplace is the admitted marketplace. Well, that's not so. As you are seeing in Florida with the catastrophic risk, the alternative to the nonadmitted marketplace is no coverage at all. So I think you have to return to the idea, this is not compulsory coverage, you don't have to have it. So what you are insuring is the corporate treasury which, with all due respect, allows the corporation to continue to do business and employ people and serve the public in its own way.

The other great confusion that is interwoven in the critiques is the idea that, somehow, if you identify the particular State that's going to be charged with the regulation, you are going to interfere with the rate-and-form regulation of the policy whether or not the torts are covered, because they're different from one State to the other, whether or not the Michigan regulator is adequate to evaluate earthquake exposure or hurricane exposure.

Well, the fallacy there is there is no rate-and-form regulation in the nonadmitted marketplace. The only regulation of the nonadmitted market—and there's no claim regulation either in terms of the carriers making payments.

There is no regulation of the carrier at all in the nonadmitted marketplace; the regulation is of the broker. It governs when they can access the market, whether they're licensed to access the market, with whom they can place coverage by different criteria, or white lists, that are established by the National Association of Insurance Commissioners; and then, most importantly for many States, how they get their piece in terms of the premium tax payment.

There is no regulation of the policy itself or the claims payment process. And so those critiques may be very fair in another context; they are not fair with respect to the nonadmitted insurance piece covered by title I.

Ms. LAWS. Representative Wasserman Schultz, could I also respond?

Mr. CANNON. The gentlelady's time has expired, but if you would like to respond, I think Mr. Plunkett would also like to respond. So we'll have you respond and then he may respond.

Ms. LAWS. I'll be brief.

One of Mr. Plunkett's assumptions, he questioned the assumption as to whether the domiciliary regulator had the incentive to provide adequate oversight to the reinsurance transaction, and he questioned the impact on the consumer.

First of all, I would reiterate that there is no consumer aspect to the actual reinsurance transaction itself. But more importantly, I would say that the States have absolutely no incentive in not regulating the financial solvency of a reinsurer, which can have adverse impacts on the insurer and consumer ultimately. Every State regulator has every incentive to make sure that those insurers are going to be financially solvent, as demonstrated by the fact that reinsurers are paying such large parts of the catastrophe losses.

Thank you.

Mr. PLUNKETT. Well, it's a long list here.

Let's start with what Mr. Soto had to say. $1 billion in personal lines; it's just under, he's correct. Our concern is that given the intent of the legislation that that number would grow significantly.

I mean, it's one issue if a sophisticated corporation is buying commercial insurance; it's another issue if the nonadmitted market for personal lines grows. Why not just exclude personal lines? Why not make it very clear in the legislation that it's not covered?

The next item, I'm not saying that in all cases the alternative to the nonadmitted market is the admitted market. We know that in some cases we're talking—in many cases we're talking about unusual risks that have to be covered, or risks that are not available in the admitted market, but this bill forbids States from requiring brokers to do what they have to do now, which is to do a search of the admitted market before placing somebody with nonadmitted insurance. So we're very concerned that nonadmitted lines could grow significantly, and especially concerned about the impact on personal lines.

I disagree that there's no consumer impact when it comes to regulation of reinsurance. If one State—entities in that State say that the domicile State is 1 percent of the reinsurance coverage and in another State it is 75 percent, but that State is not the domiciled State, why not allow that State, in some circumstances, some regulatory authority here?

Thank you very much.

Mr. CANNON. Thank you.

Mr. Sinder, it looked like you had wanted to respond there.

Mr. SINDER. To the point about access to the market, the legislation requires that you're governed there by the home State of the company, and there their rules govern. And every State says you have to evaluate whether or not the coverage is available in the marketplace. That rule would continue; the difference is the documentation of the availability.

Right now, some States say you need five affidavits; other States say you need to document your own file your own way; other States say you need three letters for carriers. That gets to be a pretty thick file for single placement for multistate exposure.

So it's not that the rule goes away. It's just that it gets reduced to whatever the requirement is in the insured's home State.

Mr. CANNON. Thank you, Mr. Sinder.

Let me explain why we're here. This is the Subcommittee on Administrative and Commercial Law, and we oversee interstate transactions, regulations that interfere with commerce and also interstate compacts. So NAIC is a compact that we—that we oversee. And what I'm hearing here is there is clearly a bunch of activity by the individual States that affects the smoothness with which commerce should happen.

But I'm intrigued by the discussion that we're having here, and we've been talking about this—Mr. Plunkett initially talked about auto insurance where—I suspect there are not many States that don't have a lot of auto insurance policies.

Another area that is a little different is in health savings accounts, where many States don't have much in the way of offerings.

I think Utah has two or three health savings accounts; those are recent and they're not of very general applicability.

Is it possible in an area of—consumer area, as opposed to a sophisticated business that we might move into insurance health savings accounts or other kinds of personal insurance with nonadmitted insurers if this blows past, Mr. Sinder?

Mr. SINDER. Right now the nonadmitted insurance marketplace is a property and casualty insurance marketplace, not a benefits insurance marketplace. So this legislation would have no direct effect on things like health savings accounts, which are really securities products that are tied to the availability of—if you purchase a certain type of health coverage.

On the auto, in most States, maintenance of auto insurance is compulsory, and so you have to have the auto insurance in order to maintain either an individual or a commercial license. When insurance is compulsory, it's not just that you're required to maintain insurance; you're also required to maintain insurance from an admitted carrier regulated by that State. So if you are, for example, General Motors and you have drivers in all the States, each of those States requires you to maintain insurance coverage for those drivers with carriers admitted in those States. So it really isn't a type of coverage that's amenable to a surplus lines product that's only for noncompulsory insurance.

Now, to the extent for those same drivers or for your driver pool, you would like to purchase some top-end coverage, that very well may be a product that's amenable to surplus lines coverage, and it could be purchased in that marketplace. But, again, it's something you are purchasing as extra protection, not coverage that's required by the State.

Mr. CANNON. Mr. Plunkett, you were concerned that the one billion of the 33 billion could grow dramatically. What areas would that grow in?

Mr. PLUNKETT. Excuse me. Currently, we have nonadmitted lines for personal insurance sold in any area you can think of. I mention auto insurance and property coverage for brush fires out West. It tracks normal personal lines in many ways, so we're concerned on property casualty insurance, as was mentioned, about the growth of these personal lines of nonadmitted insurance.

Mr. CANNON. Mr. Sinder.

Mr. SINDER. Mr. Chairman, it's true that you can purchase auto insurance in the nonadmitted marketplace, but not for your collision coverage and not for your basic, required auto insurance coverage. What you purchase it for is, if you have a very specialized automobile, a classic antique car that your normal admitted carriers won't cover the collision on the auto itself, so you purchase a slice of coverage. And you may do it through the nonadmitted marketplace, but it if you are a consumer, you are an individual, the State in which you reside, they regulate that transaction. And so you still have all the normal regulatory rules applied; it's just that for certain slices of noncompulsory insurance, you may indeed access that nonadmitted marketplace.

But the other thing I would like to point out is the brush fire example. The reason you may need to do so for that type of exposure is because you can't get that coverage in the admitted marketplace,

so this marketplace really fills a gap. I don't believe that for most consumers who reside in a single State, this will have any effect at all on the way in which their insurance transactions are regulated.

Mr. CANNON. I don't know if any of you can actually answer this question clearly, but we may guess: What effect is this legislation going to have on NAIC as an institution and on individual commissioners or individual States if it's passed? I take it there would be a significant amount of work to put it in place, but I suspect there would actually be less work and more clarity on revenues, at least for those States.

Mr. SINDER. Yes. I think that at the front end there is some work to put a compact together to effectuate the tax-sharing provisions, and the NAIC has already begun that process at their last meeting. This has kind of reinvigorated their efforts on this. They had been making efforts to do a surplus lines compact for over 20 years and those efforts had stalled, so this has reinvigorated those. But once the compact is in place, the bulk of the surplus lines transactions are for single-State placements.

This legislation has absolutely no effect on the regulatory control or efforts related to those placements. The place where it will—you will see some savings is, you won't see for the multistate transactions the duplicative filings from State to State, so there should be some administrative savings for all insurance departments.

Mr. CANNON. Will there be a shift of revenues to States that have more corporations based in those States and away from States where you have branch offices? And will that be significant? You, Mr. Sinder or anyone else.

Mr. SINDER. Well, the CBO did a study on this and they predicted a small amount of tax shifting. It's an incredibly difficult calculation to make.

Mr. CANNON. Is that Federal tax by the CBO or is that intrastate?

Mr. SINDER. They evaluated both. They saw some intrastate tax shifting. But there's a couple points here. First of all, the expectation is that the overall tax revenue to the States will actually increase because there is a sense that there is some—it's difficult to comply with the rules, so some don't—no members of the council, of course, but others who may be out there who are playing in this area.

Mr. CANNON. And you may just not know.

Mr. SINDER. No one has told me. That's definitely true. I'm sorry, I lost my train of thought.

Mr. CANNON. No members are not paying, so there should be net—with the noncompliance removed, there should be a net benefit or a net gain.

Mr. SINDER. There should be a net benefit. But initially some thought that the large States would be beneficiaries of this. But at the House Financial Services hearings there was concern that some small States where you have—large corporations that reside would actually be the big beneficiaries because they wouldn't pay the tax based on their nationwide exposure.

The truth of the matter is that once the compact is in place, it should be a much fairer, more efficient tax-sharing mechanism, and

in the interim it's very difficult to predict the tax impact because some companies that are large—and the example used at the House Financial Services Committee was Wal-Mart—they may be in the surplus lines marketplace, but they may self-insure for the bulk of these risks, as well; and by removing the regulatory impediments, what you may do is shift them back to using more traditional, nonadmitted carriers to satisfy the risk exposure.

Mr. CANNON. Thank you. I've gone over my time here, but so did the Ranking Member slightly. So let me just wrap up by saying, it makes an enormous amount of sense, Mr. Soto, as you suggested, to have regulation at the lowest level. As you point out, can you imagine FEMA responding the way the—the way the Florida commissioner of insurance responded? It is beyond conception.

That's why I think this is really a cool Committee, and we welcome Ms. Wasserman Schultz, however temporarily, to the Ranking Member's seat.

Do you have other questions?

We would like to thank the panelists for being here today. I think it has been very informative, and we look forward to helping move this legislation forward. Thank you very much.

[Whereupon, at 11 a.m., the Subcommittee was adjourned.]