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REFORMING INSURANCE REGULATION: MAKING THE MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTEREPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

NOVEMBER 5, 2003

Printed for the use of the Committee on Financial Services

Serial No. 108–63

U.S. GOVERNMENT PRINTING OFFICE

93–423 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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REFORMING INSURANCE REGULATION: MAKING THE MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

Wednesday, November 5, 2003

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:30 p.m., in Room 2127, Rayburn House Office Building, Hon. Richard H. Baker [chairman of the subcommittee] presiding.

Present: Representatives Baker, Shays, Bachus, Royce, Kelly, Miller, Tiberi, Kanjorski, Sherman, Inslee, Moore, Lucas of Kentucky, Israel, Ross, Emanuel, and Scott.

Also Present: Representative McNulty.

Chairman BAKER. I am informed that Mr. Kanjorski is on his way. With that understanding, I am going to proceed to call our meeting of the Capital Markets Subcommittee to order for the purpose of receiving testimony today on the advisability and need for reform of our current national insurance regulatory marketplace.

I am looking forward to hearing the perspectives of the members of our distinguished panels today as to the need for, and the nature of, proposed regulatory reform. Over the past years, the subcommittee has examined this subject matter and received various recommendations and stated plans of action. We certainly hope to hear encouraging reports on the status of those reform efforts.

I feel it is very important to state that reform is essential, because delivery of product to consumers, where limited, now results in unnecessarily high premium rates. The lack of competitive product in the marketplace only further sustains those non-responsive rate structures.

I do think it appropriate for the committee to move only after careful analysis and understanding. But we should seek the broadest possible scope of reform while recognizing the importance of the State structure in the protection of consumer interests. I do not think those goals are mutually exclusive.

While we seek the broadest scope of possible reform, I also understand there are limiting factors for proposals that may not ultimately gain Congressional approval. Other than no reform, dead reform is equally unacceptable. I appreciate the efforts made to date by all of the parties who have exhibited interest in seeing national uniformity in various perspectives, but I don't think that we

frankly have made sufficient progress through the current hearing date that would not in fact cause the Congress to take further actions on its own initiative.

It is my hope that we receive from each perspective, from all market stakeholders, recommendations that can be weaved together into some sort of policy platform that could possibly lead to congressional action next year. Short of that, it would be my hope we could at least reach agreement on a time line by which meaningful reforms could be attained through State and local initiatives, and, absent attaining that goal, suggesting automatic congressional action after waiting a few more years.

I am not encouraged, because the Graham-Leach-Bliley effort only took about 75 years. Sarbanes-Oxley, fueled by a national crisis, took a few months. Somewhere between a few months and 75 years, I think the insurance regulatory structure is probably solvable. Seeing how we are closing out the first real decade of discussion on this matter, maybe we are further down the road of progress than some may expect.

Given those perspectives, I certainly welcome each of you to the hearing today and look forward to receiving your comments.

Chairman BAKER. Let me turn to this side. Is there any member on this side who has an opening statement that would—Mr. Israel.

Mr. ISRAEL. Mr. Chairman, I had planned to introduce one of our experts, if it is appropriate to do that now.

Chairman BAKER. Since we have a number of requests for members to introduce, particularly members of this panel, and while we are waiting Mr. Kanjorski, why don't we proceed with those specific introductions.

Please proceed, Mr. Israel.

Mr. ISRAEL. Thank you very much, Mr. Chairman. I appreciate your convening this very important hearing on insurance regulation. And while there is a diversity of opinion on this issue, and while I continue to study it, I am very pleased that one of our experts today is a distinguished elected official on Long Island, which I represent, and it is my privilege to introduce him to the committee.

He is a fellow Long Islander, Senator Kemp Hannon, of New York. He is Co-chair on the National Conference of State Legislatures Task Force on the Federalization of Insurance Regulation. Senator Hannon is uniquely qualified to provide us with insight into the ongoing debate of the role of the Federal Government in insurance regulation.

Senator Hannon also serves as the chairman of the New York State Senate Health Committee, and has previously served as chair of the Council for State Governments Committee on suggested State legislation.

I am very eager to hear his insights. I look forward to working with him and enjoy the relationship, the bipartisan relationship that we have on Long Island. I am so pleased to welcome him to this committee today.

I yield back my time, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Israel.

I believe Mr. Ross has an introduction that he would like to make at this time.

Mr. ROSS. Thank you, Mr. Chairman.

One of our panelists today, an expert witness, comes from my home State and actually grew up in my district and is someone I think is doing an outstanding job on behalf of our state.

And I am pleased to introduce Mike Pickens, the Commissioner of Insurance for the State of Arkansas. And Mike was appointed Insurance Commissioner in 1997, back when I was still in the State senate, and was reappointed for a second 4-year term in 2001. He is a graduate of Pine Bluff High School, which has an exceptional football team this year.

He has attended the University of Mississippi, or Old Miss as we call it, in Arkansas, and he returned to the University of Arkansas at Little Rock where he attended the school of law, and received his juris doctorate degree.

And prior to his post as the Insurance Commissioner, Mike was a partner in the Little Rock law firm of Friday, Eldridge, and Clark where he practiced in the areas of insurance defense, representing policyholders in personal injury and workers' compensation litigation.

In Arkansas, the Commissioner is responsible for protecting insurance consumers through insurer solvency and market conduct regulation. And, as a licensed independent insurance agent myself, I can speak firsthand to the efforts of this agency in ensuring that companies conduct their businesses fairly and in a manner that puts the consumers first.

The Arkansas Insurance Department has been identified as one of the Nation's most progressive insurance regulatory agencies by the A.M. Best Company, one of the country's oldest and most highly respected insurer rating organizations.

Mike was elected President of the National Association of Insurance Commissioners back in 2002, which is composed of the chief insurance regulatory officials from the 50 States, the District of Columbia, and four of the five U.S. Territories.

I am pleased to hear that the National Association of Insurance Commissioners is making progress in its efforts to modernize State regulation with implementation of the insurance regulatory modernization action plan that was adopted back in September of this year.

I look forward to Mike's testimony and the other witnesses' that have joined us today, and I appreciate this committee's commitment to examining this industry that is essential to all Americans. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Ross.

Mr. McNulty, would you care to make an introduction?

Mr. MCNULTY. I thank the Chairman and the Ranking Member for allowing a nonmember of the committee into the room today for the purpose of making an introduction.

I also want to welcome Commissioner Pickens, whom we have surrounded by New Yorkers. I also want to extend greetings to my very dear friend, Senator Kemp Hannon, with whom I served in the assembly many, many years ago, and Greg Serio, the Superintendent of Insurance from New York, who will be introduced a bit later by another member of the panel, but who I want to greet because he is a friend and he is a constituent.

And, finally, I want to introduce my longtime friend, Senator Neil Breslin. Senator Breslin is not just an outstanding lawyer and a great Senator, and considered an expert on insurance issues, but, more importantly to me, he and the members of his family have been friends to me and the members of my family for a very, very long period of time. And it is always great to be with him, to work with him, and to welcome him to Washington, and I look forward to being with him soon back home in the district.

So I welcome all of the panelists, especially my State Senator. Thank you, Mr. Chairman, and I thank the Ranking Member.

Chairman BAKER. Thank you, Mr. McNulty.

Mrs. Kelly, did you wish to make an introduction at this time?

Mrs. KELLY. I do. And thank you very much, Mr. Chairman. I really appreciate your holding this hearing on improving insurance regulation, which is an issue of great concern not only to me and the members of the committee, but to people across the country who are consumers of the products.

Today we are going to have a lot of diverse witnesses with distinct interests, backgrounds, and experiences. And despite all of these unique perspectives, I think we all agree that protecting consumers and providing the best service possible are really the goals that we are focused on here today.

I think we also all agree that a lack of consistency and regulation from State to State hurts Americans by undermining protections and driving up costs. And the solution is a more efficient and systematic approach to regulation.

As we continue our work on these issues, I am really honored to have the opportunity to introduce—we have a couple of witnesses from the State of New York. I understand that some have been introduced, but I would like to introduce the Superintendent of Insurance, Greg Serio. He has been wonderful for our offices to work with.

And, Greg, we are very happy to have you here today. There is a lot of important issues that we are going to discuss here today. But I don't think there is anything that is more important than doing what we have to do to make sure that not only are we protecting our consumers, but that they understand the products that they are purchasing.

And, I believe that Mr. Serio has prided himself, and I am happy, too, because I applaud him in what he has been doing, because while carrying out his duties as a Superintendent of Insurance in New York, he has undertaken many successful programs and initiatives at the New York Insurance Department, including a successful effort to adopt the model producer licensing statute.

I also would like to welcome Senator Breslin. I understand someone has also introduced you. It is a pleasure to have you all here today. I am hopeful that we are able to wrap our arms around this and come to some conclusions on it. We tried a long time ago, several years ago, to address this issue, and tried to get passed a bill that the insurance industry had been interested in trying to get passed for self-regulation since 18—it was pending in Congress since 1847. We got part of it done; we just have to get the rest of the job done. I am hopeful that some of the testimony today is going to finish that up.

It is really a pleasure to have you here. I look forward to your testimony and to your initiatives that you are offering to modernize insurance regulation in a way that is going to better serve all of us.

Thank you, Mr. Chairman. Yield back.

Chairman BAKER. I thank the gentlelady.

Mr. Kanjorski for an opening statement.

Mr. KANJORSKI. Thank you, Mr. Chairman. We meet today for the second time in the 108th Congress to consider insurance issues.

Today's hearing will focus on the latest modernization efforts announced by the National Association of Insurance Commissioners, and the prospects for achieving State-based regulatory reform.

Before we hear from our experts, I believe it is important to review some observations about the insurance industry that I have raised at our previous hearings on this matter.

Insurance, as my colleagues already know, is a product that transfers risk from an individual or business to an insurance company. Every single American family has a need for some form of insurance, especially products like auto, renters' or homeowners' insurance. The vast majority of these families also has or wants other insurance products, like life, health and long-term care policies.

The McCarran-Ferguson Act authorized the States to regulate the insurance business. And 4 years ago this month, the Congress reaffirmed this system in approving the law to modernize the financial industry. As a result, each State currently has its own set of statutes and rules governing the insurance marketplace. Traditionally the States have highly regulated the insurance industry. Many States, however, have begun to experiment with their regulatory models in recent years. In the last several sessions of Congress, our committee has held regular hearings about the need for regulatory reform in the insurance industry.

During these debates, we have heard from a variety of viewpoints on the need for reform and the options for achieving it. These hearings have also helped to educate us generally about the mechanics of the insurance industry and the latest regulatory developments in it. As a whole, however, the Federal Government continues to lag behind in its knowledge of insurance issues.

As our witnesses from Mass Mutual will point out later today, the insurance business is the only portion of the financial services industry that does not have a regulatory presence in Washington.

At times, this lack of expertise has caused difficulties for us. For example, although many Members of Congress had concerns about the insurance industry's ability to respond to the 2001 terrorist attacks, they had difficulty in immediately identifying Federal experts to advise them in these matters.

The deficiency of Federal knowledge about the insurance industry might have also impeded our efforts to adopt expeditiously the terrorism reinsurance backstop law. Everyone involved in the debate on future insurance regulation agrees on the need for reform.

From my perspective, promoting competition through fair and effective regulation should ultimately result in better and more affordable insurance products for consumers. While I am pleased that the National Association of Insurance Commissioners recently re-

leased an action plan for pursuing further modernization efforts for regulating the insurance marketplace, this proposal was developed 3-1/2 years after the release of its paper calling for the efficient market regulation of the insurance business.

Absent demonstrated advances in these State insurance regulatory efforts going forward, the Congress may need to consider altering the statutory arrangements through the creation of an optional Federal chartering system or the adoption of other reforms.

In closing, Mr. Chairman, I want to commend you for bringing these matters to our attention. I believe it is important that we learn more about the views of the parties testifying before us today, and, if necessary, work to further refine and improve the legal structures governing our Nation's insurance system. I yield back.

[The prepared statement of Hon. Paul E. Kanjorski can be found on page 59 in the appendix.]

Chairman BAKER. Thank the gentlemen. Mr. Lucas.

Mr. LUCAS. Mr. Chairman, I am not big on formal opening statements, but I would like to say that this is of a particular interest to me, since I spent, in my prior life, 32 years in the insurance business and I had a lot of frustrations about the speed to market of products and so forth, working in many States.

And I look forward to the testimony here. And I am hoping that we can move forward and get some very meaningful reform. Thank you.

Chairman BAKER. Thank you, Mr. Lucas.

Mr. Bachus, did you have an opening statement?

Mr. BACHUS. Mr. Chairman, I will make it brief. I want to thank you, first of all, for holding this hearing. Since the jurisdictional change in 2001 to include insurance as a part of the House Financial Services Committee, I have heard from numerous regulators in various sectors of the insurance industry on this very important issue.

While I applaud the life insurance industry for attempting to make their case of the need for a dual system of insurance regulation in their bid to compete with federally regulated security products, I still have many concerns regarding various proposals for an optional Federal insurance charter. In particular, proposals which include the property and casualty line of insurance as a part of the Federal charter.

As you may know, Alabama has a $1.3 billion per year insurance business, resulting in $240 million of insurance premium taxes every year. A proposed optional Federal insurance charter not only could reduce this important source of State revenue in an era of tight State budgets and dwindling State income taxes but will also threaten the ability for States to adequately fund their State insurance departments.

Issues such as state insurance premium taxes must be addressed as part of any optional Federal insurance charter. Currently our Alabama Insurance Commissioner, Walter Bell, is working with the National Association of Insurance Commissioners on an insurance regulatory modernization plan, which will include a streamlined uniform regulatory process for product approval and additional consumer protections.

I look forward to hearing about this proposal today from the NAIC, and comments from the independent insurance agents on this new proposal.

In addition, I look forward to listening to representatives of Mass Mutual, Hartford, and the Council of Insurance Agents and Brokers on their innovative proposals for modernizing our insurance regulatory system.

And again, I thank you for holding this hearing.

Chairman BAKER. Thank you, Mr. Bachus.

Any member desiring to make an additional opening statement? Mr. Scott.

Mr. SCOTT. Thank you very much, Chairman Baker and Ranking Member Kanjorski. I want to thank you for holding this hearing today. And I just want to also just mention how important the insurance industry is.

Several of my constituents have expressed opposition to a national approach, but nevertheless I will listen today to the testimony with an open mind. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Scott.

Any further opening statements? If not, at this time I would like to proceed to recognize the members of our first panel.

The first to be recognized would be the Honorable Mike Pickens, Commissioner of Insurance for the great State of Arkansas, who appears here today as the President of the National Association of Insurance Commissioners, and is accompanied by the Honorable Gregory Serio, Superintendent of Insurance from the State of New York.

Chairman BAKER. Mr. Pickens, you are certainly warmly welcomed here today.

STATEMENT OF HON. MIKE PICKENS, COMMISSIONER OF INSURANCE, ARKANSAS, AND PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS; ACCOMPANIED BY HON. GREGORY SERIO, SUPERINTENDENT OF INSURANCE, NEW YORK

Mr. PICKENS. Mr. Chairman and members of the subcommittee, thank you very much for allowing us the opportunity to be here today. It truly is a privilege to have a chance to advise you of the progress State regulators have made in our consumer protection and market-oriented regulatory reform efforts.

I particularly appreciate my Representative, Mr. Mike Ross, or one of our Representatives in Arkansas, and his kind introduction.

First, though, Mr. Chairman, I would like to take this opportunity to thank you for your interest in and your support of our important work. Your oversight of State insurance regulation truly has been a positive force for necessary change. And we recognize that.

I commend Financial Services Committee Chairman Mike Oxley. I commend you, Mr. Chairman, and I commend all of the members of the Financial Services Committee for what I believe is your highly progressive leadership on these issues.

Mr. Chairman, let there be no doubt, State insurance regulators are committed to creating a regulatory system for the 21st century, one that both protects our fellow insurance consumers but also one

that facilitates growth and stability in the financial services marketplace.

Our goal is very simple: It is to make regulation more effective and more efficient; but also, at the same time, to make it less costly and less burdensome. I believe we have demonstrated commitment by our expeditious compliance with the Graham-Leach-Bliley Act of November of 1999.

The NAIC has to date certified 41 States as being GLB-compliant in producer licensing. That constitutes 67 percent of the premium volume in the country. We expect very soon to certify New York, who just passed a bill this summer as being GLB-compliant. And when that happens, we will have 75 percent, 75 percent of the marketplace GLB-compliant.

All 50 States and the District of Columbia have passed privacy laws or regulations to protect consumers' personal financial and health information. And as has already been mentioned today here, Mr. Chairman, in September State regulators unanimously passed a reinforced commitment insurance regulatory modernization action plan.

This action plans sets out our goals in the areas of consumer protection, market regulation, speed to market for insurance products, producer licensing, insurance company licensing, solvency regulation, and change in insurance company control. The action plan also allows the NAIC to use our highly successful financial solvency accreditation program to enforce compliance where it is necessary and appropriate to do so. This action plan sets deadlines by which States should accomplish these goals.

And, Mr. Chairman, I am here today, first and foremost, to commit to you that the NAIC and State regulators will reach these goals, but also to tell you that we can't do it alone. I believe, significantly, we are not alone in our efforts. Over the last several years we have enjoyed some very important allies in our work, all of whom—or many of whom, I should say, are at the table with me here today: the National Conference of Insurance Legislators, a group that Chairman Oxley helped found, and the National Conference of State Legislators have endorsed the NAIC's interstate compact for life insurance, annuity, disability and long-term care products. We received that endorsement just this summer.

Both NCOIL and the NCSL have signed joint resolutions with the NAIC, clearly stating their support of State regulation of our modernization work, and also their strong opposition to a Federal regulator of the business of insurance.

In October, the Council of State Governments passed a similar resolution that was sponsored by the CSG chair and my Governor, Mike Huckaby, in Arkansas.

Mr. Chairman and Members, State regulators want and need your help and support, too. You each are very influential political leaders in your respective States. Please help us keep the pressure, help us keep the pressure on the insurance industry and encourage them to support our modernization efforts, not to undermine them in the States.

Mr. Chairman, we also believe that it is important to note that the vocal minority of the industry out there calling for a Federal regulator for insurance consists of the very largest banks and life

insurance companies that operate in the country today. The insurance business is significantly different from the banking and securities business. It touches every man, every woman, every child, every family in this country, including your families and my family. And the only people standing between all of us consumers and what far too often becomes these huge corporate bureaucracies are home-State, home-grown insurance regulators.

Is it the real consumers our States, the grassroot consumers that are in Washington asking for a Federal regulator of the insurance business, or is it just the lobbyists for these huge insurance companies? Ask your constituents if they want to call some far-away government bureaucracy to help them with a consumer complaint about their roof or their car or their home or a life insurance or health insurance policy.

If you ask your constituents—who I assure you don't always understand the legalese and the small print that are in ever-increasingly complex insurance policies. When a consumer needs to call 911, they want that call and they expect that call to be a local call, not a long distance call.

And as taxpayers, I think all of us would agree that none of us can afford the creation of yet another huge new costly bureaucracy in Washington, D.C., one that most certainly, ultimately, will be less accountable and less responsive than home-State regulators.

Finally, the insurers and the agents in our States don't want the increased costs and the multiple layers of regulation a Federal regulator ultimately would create. And our State governments and our consumer protection guarantee funds can't afford what would inevitably be the loss of premium tax and other revenues that must ultimately go to fund a Federal regulator. And Mr. Bachus has already alluded to that. That is a serious concern for our governors and legislators.

So in closing, Mr. Chairman and subcommittee members, let me just again ask that you please continue to support our State-based, market-oriented regulatory modernization efforts. All of us that are grassroots consumers in our States want and need you to do so.

Again, thank you for your leadership. Thank you for the opportunity to visit with you here today. And we look forward to answering your questions.

Chairman BAKER. Thank you, Commissioner.

[The prepared statement of Hon. Mike Pikens can be found on page 110 in the appendix.]

Chairman BAKER. Our next witness this afternoon is the Honorable Neil Breslin, State Senator from the State of New York, who appears here today on behalf of the National Conference of Insurance Legislators. Welcome, Senator.

STATEMENT OF HON. NEIL BRESLIN, SENATOR, NEW YORK STATE, ON BEHALF OF THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

Mr. BRESLIN. Chairman Baker, members of the subcommittee, thank you for inviting the National Conference of Insurance Legislators, or as we refer to NCOIL, to testify before you here today.

I am a New York State Senator, representing the city and county of Albany, which amounts to some 300,000-plus people.

NCOIL is a nonpartisan organization of State legislators whose primary purpose is to develop and promote legislation that protects consumers and fosters a vibrant insurance industry.

As I stated in testimony before Chairman Oxley and the members of the Subcommittee on Commerce in the year 2000, NCOIL welcomes the oversight of Congress on insurance regulation. We are grateful for the ongoing dialogue with the committee and efforts to improve the State-based insurance regulation.

Under State regulation, insurance markets have grown and become increasingly competitive. There are more than 3,300 property and casualty insurance companies and over 1,800 life and health insurance companies now in competition throughout the U.S. Markets.

At the outset, I would like to commend the NAIC for their work to improve insurance regulation. Their recently adopted action plan clearly demonstrates their understanding of the challenges facing insurance regulations in the 21st industry. While such pronouncements are laudable, they demand follow-up with real measurable results, and, more important, such regulatory improvements need to happen without delay.

And I might parenthetically add, the NAIC, NCOIL, and the NCSL are working together in a way that they never did before.

In my testimony today, I will report to you on the progress NCOIL has made to improve regulation of the insurance marketplace and our vision for continued modernization.

The key areas of reform. I am here to say that insurance regulatory modernization is well on its way. By the end of the year, NCOIL will have adopted model laws or passed resolutions in support of NAIC model laws addressing four areas of insurance regulation, requiring immediate improvement.

I would like to take a moment to provide you with a brief overview of what NCOIL has done in each of those areas. First, as Commissioner Pickens pointed out, insurance producer licensing. The States rose to the challenge to reform producer licensing laws, albeit on the threat from the Federal takeover of the multi-state licensing function as proposed by NARAB and GLBA. The number of States was 29. We far surpassed that. Today the NIC has certified 41 States as meeting the requirements for producer licensing reciprocity under GLBA. I am happy to report that the last State last month was New York, and I can assure you that the bill will pass the muster of the GLBA requirements.

Secondly, speed to market for insurance products. Critics of State regulation point to a State-by-State regulatory approval process as too slow and too cumbersome, putting insurance carriers on an unlevel playing field with other financial service providers.

NCOIL has taken a two-pronged approach to improving the insurance product approval process. First, for the approval of property casualty products, NCOIL has adopted the Property Casualty Insurance Modernization Act. The NCOIL model is a step towards the competitive rating system which is found in Illinois.

The NCOIL model offers States an alternative to prior approval mechanisms that can stifle innovation and force higher prices upon all consumers. To date, several States have based their insurance

rate modernization initiatives on the concepts found in the NCOIL model law.

Second, for the approval process for life insurance and related products, NCOIL worked closely with the NAIC and the NCSL with the development of the Interstate Insurance Product Regulation Compact. It was my privilege to recommend the compact approach and testimony at a hearing here in Congress in the year 2000. NCOIL earlier this year adopted a resolution supporting the compact and is encouraging the States to consider it during the 2004 legislative session.

Thirdly, company licensing. NCOIL adopted in July of 2000 the Company Licensing Modernization Act. The model act can promote consistency among the 50 States in licensing insurance companies, using procedures in the NAIC uniform certificate of authority application.

The NAIC has made good progress streamlining and simplifying company licensure through its ALERT program. However, State-specific deviations still remain. State enactment of the NCOIL company licensing model will bring greater uniformity to company licensing.

And, finally, market conduct regulation. As NCOIL past President Terry Park testified in May of this year before the Oversight and Investigations Subcommittee, problems with the current market conduct regulatory system are glaring.Representative Park based his statement on a 4-year study made by the research arm of NCOIL. Those findings of the NCOIL study are consistent with State market conduct regulations found in the recent GAO report on market conduct.

As Representative Park testified in May, NCOIL planned to begin developing a model law addressing the problems with market conduct. I am happy to report to you that NCOIL will consider a market conduct surveillance model act when it convenes its annual meeting later this month. That model act would provide a statutory framework for market conduct regulation currently not found in most States. Once the model law is adopted by NCOIL, and enacted by the States, market conduct regulations will provide consumers with a greater level of protection than they have today.

In conclusion, it is no coincidence that over the past 3 years, NCOIL has doubled its efforts to bring about real and measurable improvements to the insurance regulation. State legislators are acutely aware of the forces at work to create an optional Federal charter for insurance companies.

Our heads are not in the sand. We understand that political and marketplace realities demand that we improve State regulation. We understand that the status quo is not an option. In previous testimony before this subcommittee, NCOIL articulated its unwavering opposition to any encroachment on State insurance regulation. Our position has not changed. NCOIL strongly believes the creation of a new Federal bureaucracy would be unwise and most likely harmful and counterproductive to insurance buyers.

NCOIL welcomes the attention that you, Chairman Oxley, and other members have given to the issue of insurance regulation. There is no question that your focus has expedited the pace of reform.

I would be happy to answer questions after the panel. Thank you very much, Chairman.

Chairman BAKER. Thank you very much, Senator. We appreciate your participation here today.

[The prepared statement of Hon. Neil Breslin can be found on page 61 in the appendix.]

Chairman BAKER. Our next witness is the Honorable Kemp Hannon, Senator for the State of New York, appearing today on behalf of the National Conference of State Legislatures. Thank you, Senator.

STATEMENT OF HON. KEMP HANNON, SENATOR, NEW YORK STATE, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. HANNON. Thank you very much, Mr. Chairman, members of the subcommittee. Thank you, Mr. Israel, for your kind remarks in introducing me. Thank you for the opportunity to testify on behalf of the NCSL. I have submitted some written remarks and just will make some highlights from there.

As was said, I am Kemp Hannon. I am a New York State Senator, where in that body I serve as chair of the Health Committee.

Since 2001 I have served as co-chair of NCSL's Task Force to Streamline and Simplify Insurance Regulation. Currently my co-chair is Representative Frank Martino of Illinois.

NCSL is a national bipartisan organization. And for the last 3 years we have worked hand in hand with NCOIL and with NAIC to work on a coordinated effort to streamline and simplify insurance regulation while preserving the advantages of the State system. I want to thank all of the members of this subcommittee and the staff for the interest they have had, especially since Graham-Leach-Bliley, in financial services and insurance regulation.

Our position is that we strongly support the State regulation of the business of insurance, because we believe it is a different kind of product, one best suited for State regulation. Whereas banking and securities and mutual funds are about access to capital and risk-taking, insurance is a guarantee, a legal promise to pay benefits if and when someone loses their home, their health, their income, or a loved one.

For over 150 years, we have effectively protected consumers, ensured that the promises made by insurers are kept, and we think it is a system that is worth preserving. State legislators accept the responsibility for creating a system meeting the challenges of the modern financial marketplace.

The legislators and Commissioners have developed a shared vision for modernizing insurance regulation. We already have made significant progress in critical areas, and expect to continue widespread reform in the future.

So for 2 years we have had a Task Force to Streamline and Simplify Insurance Regulation, working with the NAIC and NCOIL, open meetings, sitting, negotiating the proposed model compact for life insurance, annuities, disability and long-term care insurance, having that compact first adopted by NAIC, and then further hearings where we reached out to all interested consumers, parties, Attorney Generals in order to get comments.

We identified speed-to-market issues as the issues greatest in need of attention. The compact for life insurance, et cetera, came about with a balance, geographical balance, large State/small State balance, in terms of the amount of insurance premium regulated, as well as the geographic balance.

And the NCSL this summer endorsed a model statute, only the third time in its history endorsing a model statute. And in recognition of the significance of what this Congress has done in passing Graham-Leach-Bliley and starting a new era in regard to financial service regulation, we also endorsed this summer a statement of principles to guide State legislative efforts to modernize property and casualty insurance rate and form requirements, an area where States continue to make significant progress.

State legislators will play an important role in other areas of reform, and we endorse the NAIC's modernization action plan.

We ourselves, on an ongoing basis, have just established a Financial Services Standing Committee, so that the task force efforts can be continued as well as we can address the other issues raised by GLB.

We believe that any Federal legislation in the area of insurance regulation would be a tremendous mistake. We believe that the Federal legislation would endanger effective State regulation, undermine consumer protection, and threaten the creation of a vast new costly Federal bureaucracy.

It also risks introducing a host of unforeseen and unintended consequences. While it is easy to theorize what you would want to do in a model world for new insurance regulation, I think it is far more difficult, if not impossible, to establish and operate one. As chair of the Health Committee in New York, I deal daily with the unforeseen consequences of the 1974 ERISA Act, the first Federal effort in the area of insurance.

ERISA effectively transferred authority for employer-sponsored benefit plans, the self-insured plans, from the States to the Department of Labor and Federal judiciary. It basically created a nonsystem for dealing with health insurance and gave pretty much the regulation of that nonsystem a bad name. It would be very easy to see how Federal action in the areas of life and property and casualty insurance could bring about similar unforeseen circumstances.

And under the umbrella of my criticism of Federal regulation, I direct my attention also to the concept known as the optional Federal charter.

We encourage you to continue on the ongoing dialogue with the States as we work to modernize insurance regulation, while preserving the advantages of the State system. We think that State reform, rather than Federal legislation, offers the best promise for a regulatory system meeting the needs of both consumers and industry in the 21st century.

I thank you very much for your attention and would be very willing to answer any questions you may have.

Chairman BAKER. Thank you very much, sir.

[The prepared statement of Hon. Kemp Hannon can be found on page 86 in the appendix.]

Chairman BAKER. I will start questions with Mr. Breslin. I appreciate the observations you have made with regard to the progress by the organization in setting model reforms in place, and certainly agree that the four targeted areas that the organization has outlined are certainly critical to the reform effort we are attempting to facilitate.

You also indicated that, at least with regard to the licensing reform, that the Graham-Leach-Bliley trigger did have some operable consequence in obtaining the reforms achieved to date. Give me a reason for or reasons why, if we were to take the view in some period of time, a year, 2 years—and we will negotiate the terms—why we couldn't take the models adopted by the organization, and say that those have to be in place within a time certain.

From the perspective that Graham-Leach-Bliley mandates triggered necessary reforms at the State level, what is wrong with taking—for example, the Illinois model, which I happen to think is a very good model, your company licensing reform—I understand you are soon to adopt your market conduct regulation reform model—take your work, and, as we often do in politics, make it our own and put a trigger date on it? Respond to it, if you would.

Mr. BRESLIN. I think that ultimately may be something to be considered. But as you said in your initial remarks, we have kind of compressed 150 years into a couple of years. Graham-Leach-Bliley is 4 years old. So there was an education process after GLBA, and the education process including those States representing over 75 percent of the industry, of complying with the NARAB provisions.

So it worked there. The idea that we—if you told me 5 years ago with market conduct, that we could put together a model bill in several months and interact with the NAIC and NCSL, and interact with the industry, and be prepared to come up with that model act—which we think, because we are now educating the whole industry, that the Federal Government is going to do things unless we do them ourselves.

So I have a much more optimistic view now than I did when GLBA was passed for us to make our own repairs.

Chairman BAKER. Well, I am not arguing that the experts at the State level ought not be the contributors to the end product. What I am suggesting is we take the product you have developed and make it the model nationally, with a certain time by which the States can voluntarily implement, at the legislative level, or failing to do so in a certain period of time, ala Graham-Leach-Bliley, the Feds come in and do it for you.

Mr. Pickens, would you want to respond to that, or give me your observations about the advisability or ill-advisability of that?

Mr. PICKENS. Yes, sir, sure. I must agree with Senator Breslin. I really believe that the NAIC now has a plan. We are on time. We are on target. It has only been 3 to 4 years since Graham-Leach-Bliley was passed. We were busy passing the privacy protection regulations required by GLBA. We were busy solving the producer licensing issue.

We have made again a great deal of progress there. But I just don't believe at this point we need to consider a Federal option. There may be some point in the future when we should, all to-

gether, get together and talk about that. But at this time we have got a plan. We are on time. We are on target.

If we can get the NAIC reforms enacted in the States working with our legislative partners here, I think we will be in good shape and we will satisfy the expectations of this subcommittee and the committee in general.

Chairman BAKER. Well, does the NAIC view the NCOIL models as products which are supportable? Are you all together on the direction of reform?

Mr. PICKENS. That is a good question. I think—we have had a great deal of input, as Senator Breslin mentioned, with NCSL and NCOIL. Our relationship has become very close over the last 3 to 4 years.

In fact, we—NCOIL allowed us to work with them in passing—I am sorry, in drafting their market conduct model that they expect to vote on in Santa Fe. I think it depends on what model you are talking about, to be honest with you, whether or not the NAIC would fully support implementation of all of those models.

Obviously we prefer the action plan that we put on the table, and feel like that is what we would like legislators back in the States to help us with.

Chairman BAKER. Let me take the final piece then, because I am getting to near the end of my time. How long do you think it reasonable for Congress to wait? If I had to ask each of you for a clock, and given the fact that you have slightly different perspectives on what the marketplace ought to look like, marketplace regulation ought to look like at some point, what is that point?

Do we wait another 2 years? Is it another 20? Can you set your own self-imposed clock? We have the responsibility, I think, to make sure consumers get access to product in a responsible manner with State consumer protections. If we agree on that principle, how do we get there, and how long do we wait on the sideline until we say, look, guys, we have given it our best effort, we need to act?

Mr. PICKENS. That is an excellent and fair question. We have tried to do that in our action plan. I think if you will take a close look at attachment A, Mr. Chairman, we give you an updated status as of November 2003, number one, what our plan is, and, number two, where we are in achieving the plan.

The plan does set deadlines. For certain deadlines those reach out as far as 2008. That is the farthest deadline in the plan. The closest deadlines are December of this year. And many of the things that we have committed to in this action plan we have already done over the course of the last couple of years.

Chairman BAKER. I will probably come back on the next round. My time has expired. Mr. Kanjorski.

Mr. KANJORSKI. I know you all represent a special disposition as to the insurance industry, in terms of its State regulatory authority. Now, as a Commissioner you want to keep authority, and as legislators you like to keep it. But do you see any product or insurance activity that really does warrant national licensing or national enforcement?

Mr. HANNON. What NAIC, NCSL, and NCOIL have done is proposed a compact so that there would be a national plan to deal with the approval of products for life, long-term care, disability and

annuities. The thought on that was there was something especially needed, especially after Graham-Leach-Bliley, so that insurance companies could have a speedy time to market for their products, when they would be competing with products from companies that either had a 30- or 60-day approval or no approval required.

Now, that does not necessarily mean Federal, but it means national. But we have come up with a compact which would be allowable as an agreement among the States, so that there could be a filing with that compact entity, and once approved by that compact entity, that product could be sold in the participating States to the compact.

That would be an answer affirmatively to your question, and I believe that is a viable way to go. It preserves the State regulatory authority. It gives them an ability to compete in the marketplace.

Mr. KANJORSKI. But are you guaranteeing all 50 States will be in compliance with that one standard?

Mr. HANNON. No, but you are not guaranteed anything. In this case——

Mr. KANJORSKI. Well, if we do it by Federal law, it sure will be.

Mr. HANNON. Well, even the last Federal law in regard to insurance, as I recall, was HIPAA in 1996. And it still doesn't have 50 States in compliance with that. We still have a couple on the east coast and the west coast that haven't opted in.

So there are different ways of going about it. I think the best way of lawmaking is to get people to go about participating and buying in, whether it is by a Federal statute, whether it is by a compact, whether it is by mutual State statutes. Unless they buy in, you are going to find yourself with a statute that just is not as effective as it might otherwise could be.

Mr. KANJORSKI. Wouldn't really a compact operation just be a substitute national legislature? All you are doing is creating another arm out there representing the 50 States in the nature of a compact. Isn't that what the Congress is all about, that we are supposed to be the legislature for all of the States?

Mr. SERIO. There is a significant difference between the compact notion and a national legislator, or national legislation. And it comes down to this, and this has been proved many times in the use of compacts previously. That has been what we have been trying to do as the three groups here, and that is, take in the local environmental factors that you find in an insurance marketplace, in each of the individual States, and bring that into the policy being made.

What we are trying to establish here is a baseline, and a baseline that can then be used and has the versatility to deal with the local features, local environmental factors, that are unique to the individual States that cannot be wrapped up in one uniform standard.

Mr. KANJORSKI. Commissioner, you put your hand on the very point that I had a hesitancy as to what to do here. I think there is an absolute need to have community touch in the situation, that it shouldn't be removed completely from the average community.

But I can tell you that I am starting to get the impression that the States want to maintain jurisdiction and authority over all insurance areas that are easy. You know, just think of what has gone into the Federal responsibility over the years.

Mr. KANJORSKI. Nuclear destruction insurance, flood insurance, catastrophic insurance, terrorism insurance or reinsurance. And now, if you really look at the California wildfires, we are being called upon in the Federal Government to be a very, very large player, not in necessarily writing the policies, but picking up the cost of the losses, the inadequacies of State regulation, that action in California. At some point we might as well take jurisdiction of the insurance industry because we are in it, and we are in it in a very big way. Unfortunately, the Federal Government and the taxpayers are in insurance where we are not getting adequately compensated through premium payments; we are underwriters, if you will, where no one else will tread to bear. Wouldn't it be better if we had catastrophe insurance or casualty insurance that was national in scope, that they would get together and say, gee, we have got to come up with a policy to handle floods? And how they work that, instead of the Federal Government being an underwriter at a tremendous loss of poor planning, poor organization on the part of States and communities—because they are not bearing the responsibility and yet our constituents are, your constituents.

Mr. SERIO. I think the easy stuff hasn't been left to the States. And trust us when we say we take on any of the challenges that the insurance marketplace may throw at us. I have had this conversation with Mrs. Kelly and members of the full committee on a number of occasions where it has been the daily challenge of, whether it is the commercial liability marketplace, the market conduct in the life insurance marketplace, that the States have taken on and have taken on aggressively and directly.

The impression that may have left, and I think you characterized it correctly, isn't so much the hard stuff but it is the unique risk. But that risk is not limited to a Federal intervention and, as a result, the consequence being why don't we just simply regulate everything from the Federal level. The examples you described are extremely unique and hopefully very rare in their occurrences. In those cases where flood insurance or where the urban insurance was necessary in years past, it has always been done in a framework where the State or the local regulatory operation was largely in control of the management of that program, whether it was the urban crime insurance or even the flood insurance program, which actually turned out to be largely a market-driven program that the carriers wrote under State regulation, under the overall guidance of the Federal Government, but where there wasn't a lot of Federal intervention even in the flood insurance program. But those are unique instances. And I think if we are looking for anything where the Federal Government said, well, this is a place we really need to step in, maybe the question isn't let us find that item; rather, let us look at what the States have done across the spectrum that—is it really speed to market and auto insurance that you want to be involved in? Is it really market conduct that you want to be involved in? They are both very—well, they are all very local issues when you really come down to their impacts.

Mr. KANJORSKI. We don't have much choice if States decide to lay down conditions that if you don't have auto insurance written in that State. There are still millions of constituents in that State

that say they need that coverage, and they come down here for a remedy.

As I first described myself in the beginning—I know my time is going, Mr. Chairman—I am a person that sort of, I define myself as a Burkean; I don't change for change's sake, I usually only change when it appears that there is no other opportunity to correct the problem or I know what the results, that they will be more positive.

When I hear the national organization coming forth with an idea that we are going to have to wait until 2008 for a program to be implemented, I think that is just several years too long and too late. I would suggest to you, and honestly coming from a moderate to conservative person for States rights and other protections here, if we can't get something moved along on the State level within the next year to 18 months, I would suggest we are going to have Federal legislation.

Mr. PICKENS. Mr. Chairman, could I just add something here?

Chairman BAKER. Certainly.

Mr. PICKENS. When you talk about the flood insurance program or the crop insurance program or the cap programs that are in place at the Federal level, I think we can all agree that those programs are not without their problems, one of which is they really become where they are not insurance because there is no contingency. We know certain areas are going to flood, we know there will be wildfires periodically, we know a hurricane will hit the coastline periodically. And I would just respectfully submit to all of the committee members here today that if government becomes—it is appropriate for government to become the insurer of last resort in certain places. In other words, if the private market can't handle it, you need a safety net there where the government can step in. But the government should never—I think it is very bad for the government to become the insurer of first resort. And I think if you let them in the door a little bit, they will end up taking it over. And I would ask the committee staff maybe to look at what has happened in Japan with the CAMPO program and other places where the government really is squeezing out the private marketplace because there is never—you never have fair competition between a government entity and private entities; the government will always win.

Mr. KANJORSKI. If I may just respond, Mr. Chairman.

That would be on your part a very good argument and I would be very sympathetic to it, except there is something here other than just having fire insurance and writing protection. To a large extent, the States and the localities control, for instance, where people build homes, in flood plains or not flood plains, whether or not they build on sides of mountains that periodically burn, whether they are building buildings and factories on faults. You could be lenient or fail to administer good, smart planning out there. What ultimately ends up is the risk, is an insurable risk that lands in the hands of all the taxpayers for the whole country for generally the irresponsibility of a limited number of taxpayers, and I think that is what is getting us involved.

We would know how to encourage better planning, better social policy in this country if we were aware of the inadequacies of some

of the protections that are out there and the losses that will occur because of unintelligent planning on the State or municipal bases.

Chairman BAKER. I need to go to Mrs. Kelly now, if I might.

Mrs. Kelly.

Mrs. KELLY. As you can see, we have some bugs in our systems, too.

I would be remiss if I didn't first thank you, Senator Hannon, for all you have done for the medical safety of the citizens of New York. I am so delighted that you are here testifying on this topic, but also I just wanted to acknowledge the wonderful work that you have done for all of us in New York with regard to our medical problems and our safety.

I want to just say that it must be obvious to all of you on this panel that we are somewhat concerned that this process has dragged out as long as it has. When they wrote the NARAB bill, we thought 3 years would be a good time, and we were hoping we would get 29 States. Well, we got lots more than 29; we wound up with over 40 who are now involved. But I think it is also very clear, and this is one of the reasons I am glad to see you New Yorkers here today, New York has joined this program. But we still have a few more to go. We have got to have the big 5 in there. We have got to have Texas and we have got to have Florida and we need California. We need those States in. It has to be a 50-State self-regulatory system. If it is not, it will not succeed.

So toward that end, I would like to ask you if you feel—and anyone on this panel can answer that—that there might be a need for us to come back with some legislation that looks as though that we expect a full 50-State reciprocity and uniformity in licensing. Anyone of you can answer that.

Mr. SERIO. To have a 50-State requirement, I think—I guess the bottom line is that I don't think we are going to have to or that the committee or subcommittee is going to have to feel compelled to act. I think—and the action that has been taken already, and frankly getting New York over the hurdle was a very big effort, but it was done without doing any violence to the basic model act. And getting the other big States and the large markets involved, I think we are now on the other side of that hill. And it has been, I know it has been a focus of the committee to focus on the large market share States, and appropriately so. But now with New York and getting the other States involved, I think we are now getting there. But I think the perspective really had to be broadened out a bit to include, what are the other things that we are looking for in terms of benchmarks, producer licensing being one. I don't think we are going to be having that discussion again. But on speed to market and other issues like that, I think a critical element with any of these discussions is, what the other side brings to the table with respect to their contributions to these modernization efforts.

On the producer licensing, the agent community was extremely helpful not only in getting the bill passed in New York but in other States, but in having the legislatures who are asked to pass on this to understand what this really does in the marketplace.

Now, compare that or contrast that with speed to market. We have been talking to the legislators from the NCOIL and from the NCSL for a long time on speed to market. New York has spent a

lot of time as with Pennsylvania, Ohio, former Director Lee Covington very—a major presence in the improvement to State-based systems, yet I cannot get the property casualty industry in New York to go beyond—my numbers are somewhere in the neighborhood of 10 to 12 percent of the filings to be done on a speed to market basis. Can't get them. Don't know why. Tried it, hasn't worked.

The life insurance industry on the other hand—and it is curious that they would be asking for Federal intervention on speed to market. They are using the New York system for 50 percent of all of their filings right now; yet the property and casualty industry can't get passed 10 percent in terms of their products being filed on a speed to market basis. I think what will happen, we will be back before this subcommittee, but it is going to be a question of who has brought what to the table and how have they executed on that. That has been part of the process. When we talk about 2008, we are talking about this being done, but it really is a constant work in progress. It is a process non-event, as my predecessor liked to say. And the fact of the matter is that we may be talking about speed to market, we may be talking about market conduct, but it has to be in context of what all the various parties are bringing to the table. Because right now some of those modernizations are done, and speed to market has largely been accomplished except for the fact of the buy-in, whether it is to serve the individual States' speed to market systems or any other process, and the leveraging of technology that I think the government side has done extraordinarily well. When government has a past reputation of being stingy on technology, it actually—this modernization has actually been driven through the leveraging of technology from the government side where our customers in the industry are trying to figure out how can they match that leveraging so that they can get into these modernization systems that we have already been.

Mrs. KELLY. Mr. Pickens, you wanted to say something?

Mr. PICKENS. Yes, ma'am. I just wanted to place the comment Superintendent Serio made in a national context.

What Greg is talking about is our system for electronic write and form filing, a nationwide filing system. 50 States and the District of Columbia and Puerto Rico are on board with this.

Last month, or as of last month we had accepted nationwide nearly 45,000 forms; we expect 75,000 forms through that nationwide filing system by the end of December. The average turnaround time on those filings is 17 days. 17 days. That is speed to market. And on the producer licensing side, we have a technological initiative called NIPR, NIPR, the National Insurance Producers Registry. Anybody can participate in that, companies can appoint their agents, they can terminate their agents, they can do everything they need to do. They can file forms electronically, do the whole shooting match. And one thing that is holding us up there is that we don't have access with the big States, Mrs. Kelly. One of the things that is holding us up is the fact that we don't have access to the FBI fingerprint database, and New York and California and Florida and other States really believe that we need that access so that we make sure we are not licensing felons out in the State.

So H.R. 1408 was on the table a couple of years ago. I am not sure where it is in the process now, but that is one thing Congress could affirmatively do to help us, is give us access to that fingerprint database, and I think you would see 100 speed to market for—or not speed to market, but producer licensing ASAP.

Mrs. KELLY. Anybody else want to address that?

Thank you very much.

Chairman BAKER. Thank you, Mrs. Kelly.

Mr. Pickens, just for the record, to make sure, you referred me to your addendum in your testimony, which is the compact. And the 2008 deadline you referred to, does that include uniformity with regard to property and casualty? Or is the 2008 date only the life insurance piece?

Mr. PICKENS. Yes, sir. That is only the piece by which we have committed to get the compact passed in 30 States, or States comprising 60 percent of the premium volume for the products involving the compact.

Chairman BAKER. But that is life insurance?

Mr. PICKENS. Yes, sir. That is life insurance.

Chairman BAKER. Mr. Kanjorski departed before we got that piece of news. I think he was thinking it was 2008 to do the whole thing. So I just want to make the record clear.

Mr. Lucas.

Mr. LUCAS OF KENTUCKY. Thank you, Mr. Chairman.

One of the things that has been brought to my attention recently is that we have some States where insurance companies have pulled out because their auto insurance—because the State set the rates and they quit writing automobile insurance. But they also, if they couldn't write auto insurance, they couldn't—there are other lines they couldn't, life, health, and other things, they were not allowed to sell those.

It seems to me that, you know, we have such as sophisticated society population today, people get on the Internet and they check out air fares, hotel rates, and they obviously would do that on the insurance as well. Why would we not let competition set rates versus the States and politicians setting the rates? Who wants to answer that?

Mr. PICKENS. I will be happy to take a shot at it.

Representative, you are singing our song at the NAIC. We are a pro-competitive marketplace. The key is there. In order for rates to be a prime or to be self-regulating, you have to have a competitive marketplace. And at times you can have certain market conditions arise where you don't have a competitive marketplace in individual locales. Arkansas' homeowners market, even throughout a very hard market the last 4 to 5 years has been highly competitive, remains highly competitive. But some States have had trouble in that regard.

So that is another area where you really need that local touch, that local control that Representative Kanjorski was talking about, because one size does not fit all when it comes to auto rates. What goes into the price of an automobile insurance product has happened in Massachusetts and New Jersey, and I commend the committee for throwing the spotlight on the market problems that were

caused really by too much State governmental interference into the private marketplace.

So we are all for a balance, looking at just the right amount of government intervention into the private market, but we agree with you that prices can and should be self-regulating in a competitive market.

Mr. SERIO. Let me add to that, if I may. I think your characterization about the auto market and the way the regulators kind of approached it in terms of threatening to stop someone's homeowner writings if they want to get out of auto, things like that. The Northeast was the poster child for that philosophy for a long time. And I think as Commissioner Pickens said, Massachusetts, New Jersey, and New York included, and some other States in the Northeast used to adhere to that philosophy pretty ardently and they used to use that as their leverage when companies decided they weren't making money in the auto insurance business.

Now, in New York we had a very successful competitive rating or quasi-competitive rating called flex rating in our market which allowed rates to go up or down. But the one cautionary note I would say about any competitive rating system, and in fact any company would have to come before this subcommittee and acknowledge this. Sometimes the marketplace gets overheated and it gets too competitive and they start charging rates they can't sustain over the long term. A lot of the rate increases you saw in the markets that were not being allowed, and as a consequence of it being that companies were leaving certain States, was the result of overheated competition where the rates went too far down, they could not sustain the type of risks that they were taking on for those rates.

If you balance that out—and we are all for competitive rating of automobile insurance and using the competitive market pressures to their best and highest use. You just have to be careful that to allow a completely open and competitive market without some responsibility on the other side where they don't drill it down to a rate inadequacy situation and suddenly the regulator, whether a State regulator or a Federal regulator, is being asked the question the following year: I need a 30 percent rate increase. It is an untenable situation to put any regulator in if that is now the price of admission for a company to stay in that marketplace, because those kinds of rate swings don't do you any good, don't do us any good, and certainly don't do our constituents any good. So you need to balance that out.

But competitive rating, we have had great success in the Northeast by having a competitive or quasi-competitive rating system that has worked for the benefit of the consumers.

Mr. LUCAS OF KENTUCKY. Thank you.

Mr. PICKENS. May I add something very quickly? The competitive rating model that the chairman referred to allows for the market to set rates when it is competitive, but it also takes care of the problem that Mr. Serio talked about, because it says the regulator still has to monitor the rates to make sure that they are not excessive, too high, inadequate, too low, or unfairly discriminatory against similar risks. And this is the Illinois model, Mr. Emanuel. It is a very successful model, and if we could get that enacted

across the entire country our rating problems would be taken care of, I believe.

Mr. LUCAS OF KENTUCKY. Thank you.

Chairman BAKER. Thank you, Mr. Lucas. I just want to jump in right there and say I think we could do that.

Mr. LUCAS OF KENTUCKY. Okay. Going to a little different subject, the banking system has a dual system where banks can have a State or Federal charter. That looks like a great business model for insurance companies. What is wrong with having an optional—let us don't call it a Federal charter, let us call it a national charter, if that Federal bothers somebody. Who would like to take a whack at that? If the business model suits you better as a company, you go to the Federal.

Mr. HANNON. May I take a whack at that, Representative?

Mr. LUCAS OF KENTUCKY. Sure.

Mr. HANNON. A couple different things in regard to a, quote, optional national charter. First of all, it is not totally optional because the Federal Government isn't an equal partner. You have, rightfully so, the power of preemption for your statutes so that when you come in you totally exclude. So it is really not an option.

The second, as we have watched the optional charter for banks, we have watched the virtual disappearance of State chartered banks compared to what they were 20 years ago. The charters, it has been very attractive. The regulatory scheme has been made by the Office of the Controller of the Currency very attractive for banks to opt for the national charter; consequently, we do not have many left at the State.

If you are going to go to a national charter, you might as well say, wait a minute, we want that as a proposal. Veiling it with the thought of it being optional I think is just masking what really is the intent.

Mr. LUCAS OF KENTUCKY. Somebody correct me if I am wrong. I thought we had a lot more State chartered banks than Federal nationwide.

Mr. HANNON. I used compared to 20 years ago, where most of the major banks have now moved to Federal charter. And coming from New York, believe me, we have seen a lot of our banks opt for Federal charter.

Mr. LUCAS OF KENTUCKY. That could be in New York, but I think there is 70 percent State charters versus about 30 percent national charters.

My time is probably up, but I would like to discuss this further with the next panel.

Chairman BAKER. Thank you, Mr. Lucas.

Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman. Thank you for your interest in this issue.

I am going through thinking as we try to compete on an international basis, the EU is trying to find ways to have uniformity, and we are asking our corporations to compete in 50 marketplaces and then compete with the rest of the world. I am having a hard time understanding why it is in our best interests, the United States, to wait until 2009, 6 years from now and 9 years after this process began, to try to bring some uniformity to it on the State

level. And I want someone to give me their best argument. Why should we wait until 2009?

Mr. PICKENS. Mr. Shays, I will start with a very practical argument. If you passed an optional Federal charter bill tomorrow, it would take the Federal Government a long, long time to get up to speed. I would venture to say probably, if not 2008, beyond 2008 to regulate 3.5 million insurance agents, producers out there and the 5,000 or so companies, many of whom don't even do business in every State. In fact, I will defer to Mr. Serio on those numbers in just a second. But that is a very practical reason. The Federal Government could not get up and running that quickly on such a complex issue as insurance.

The second practical reason is the insurance industry is entirely divided over what an optional Federal charter looks like. Three of the four P&C trades are in favor of State regulation. The sole property and casualty trade that is in favor of Federal regulation can't agree with the life and health industry what a Federal charter bill looks like, and the life and health industry is divided somewhat. Life and health is more aligned with bankers, but then you have got all these other divisions out there. So the primary interest groups and the consumer groups—I must throw them in there, Mr. Hunter, others that you have heard from—they have a totally different idea about what the Federal regulator should look like. So I just don't think as a practical matter, number one, you could do it from a technical standpoint, number two, from a political standpoint you could get everybody on the same page.

Mr. SHAYS. Anybody else?

Mr. SERIO. Thank you. Let me just jump in with this observation. I suppose that this always just becomes the grass is always greener on the other side type of observation. Judging from my experience as the chairman of the Holocaust Task Force for the NAIC, and having interacted with a number of European companies who have had to navigate through their own multi-leveled regulatory systems in Europe, not just the EU but the individual countries and the individual States within those countries all regulate certain portions of the insurance business over there as well. So while there may be a unified EU market, when you drill down to some of those local companies and some of that local impact, they are dealing with a lot of the same issues that we are dealing with here.

Number two, when you have almost half of all the companies that are licensed in the U.S. operating in a single State, that State suddenly becomes more important as a focal point for those companies in terms of a regulatory objective.

Mr. SHAYS. But the EU is working to come find more common ground in uniformity. I am having a hard time understanding why I would want my American businesses to have to compete and have different rules and regulations and, you know, so many different entities. I honestly don't see the logic of why I want to do that.

Mr. SERIO. The second observation on this was that as the EU tries to sort through their own regulatory constructs, that is happening at the EU level, in the U.K. With the FSA and in Japan and in other major countries, are all sorting through what their regulatory structure should look like and we are all talking to one another.

So going back to your original question of why should we wait that long, is it really prudent to wait that long, it is happening right now. And I think what you are going to find is a certain amount of synergy between the EU's ultimate construct and the U.K.'s ultimate construct and the U.S.'s ultimate construct, between the uniformity that we can achieve on a nationalized or a federalized basis while retaining the jurisdiction at the local level, so that half of the companies that just write in a single State can continue to operate on a State regulatory structure.

One of the challenging questions—and this goes back, I think, to the Chair's question originally—what is it that the Federal Government should be focused on then? You know, is it speed to market, is it global reinsurance, or something in between that really is the proper venue or proper subject for the Federal venue? And that is still an open question. And so it may not be so much a question of will there ever be or not be Federal regulation or Federal policy with respect to insurance, but it is really other things we are talking about today, talking about the day in and day out business of regulating insurance that we have done at the State level that the individual countries of the EU have done on their levels and in their own States over the years. What we are really talking about is another set of issues: How do we deal with international trade and international reinsurance as opposed to speed to market products and agent licensing?

Mr. SHAYS. Thank you.

I would just close, Mr. Chairman, by saying I find the answers of both of you helpful and certainly giving me a perspective. But I have a tough hurdle, and that is I don't want my American businesses to have to compete so much within the United States, to have so many different rules and regulations, and then have to compete worldwide. And so we need to find a solution to that, and this appears to be the best but with some limits, and it may in fact take longer than I would like. And I thank you both.

Chairman BAKER. I thank the gentleman.

Mr. Emanuel.

Mr. EMANUEL. Thank you, and I would like to thank the Chairman for holding this hearing.

The whole concept of going to a national or optional Federal charter, and using Illinois, which I think is a good competitive system as a model, I want to make sure that we are not actually deregulating in the process.

Because when you get down to it, looking today at what has happened after the repeal of Glass-Steagall and what's occurring in the commercial banking area, you have really got three major banks that are lending and they are holding corporations over the head here in a way that nobody previously envisioned. So, I want to be sure that if we end up legislating rules, we aren't really just national deregulating under the rubric of modernization. It is what some mean by modernization that worries me. And if we do address national charter issues, in my view we have to include, property and casualty, not just life insurance.

So, we need to avoid deregulation in the name of modernization, and any solution must strongly consider the interests of consumers and "mom and pop" insurance firms.

Mr. PICKENS. Mr. Emanuel, that is an excellent question. It is one that we have struggled with——

It is one that we have struggled with at the NAIC, frankly. You have got some sectors of the industry that I think many of us believe their ultimate goal is total deregulation, and that is something that causes Commissioners concern. Then you have got other sectors of interested parties. For example, the consumer groups. Mr. Hunter I know has testified here before. He wants something totally different than deregulation; he wants something on the other far extreme, which is total regulation and strict price controls at the Federal level and things of that nature. And I think many of us are concerned that both of those things would be bad.

What you are looking for is something like the chairman talked about, I believe, competitive rating in the marketplace. In my State we have a competitive rating law, as Illinois does. It works well. I promise you if every State in the country could have as competitive an insurance marketplace as Illinois has, every consumer in the country would be much better off, and you all are not deregulated.

Mr. EMANUEL. In Illinois, we have a number of insurance companies competing in the marketplace. How do we do that at the national level, so we don't end up like the situation in commercial banking, where only three major banks are really doing the lending? How do you find the combination that unlocks the marketplace so you get competition without——

Mr. PICKENS. Yes, sir. A quick comment, and then I will defer. I don't think you do. I think you are exactly right. That is what could happen. And it could be worse, I think, in the insurance industry. Insurance is a different business than banking in many, many ways. And I think if you end up with three or four companies, what you end up with is what we had prior to the passage of McCarran-Ferguson in the 1940s, where you had large insurance trusts that were effectively setting rates and violating antitrust laws, and that is why you ended up with State regulation that you have now.

Mr. BRESLIN. I think, too, your statement was essentially the reason that we sit here and talk about State regulation, because one size doesn't fit all, and it is what has happened in Illinois because of the competitive structures there, the companies that are there, it has fit well. But translate that to another State under the same set of circumstances, and you could have what you don't want, one or two companies controlling the marketplace.

Mr. EMANUEL. The only thing I will say again is the observation that about 10 or 15 years ago on this subject all those who are now calling for a national charter of some capacity all wanted only state regulation. And sometimes I feel in these hearings lately, on this and a number of other subjects, it is like an out of body experience, because everybody that used to be for States are now for national standards, and everybody who used to be for national standards is now for State rules. So I am properly confused.

Thank you very much for being here.

Chairman BAKER. Thank you, Mr. Emanuel.

Mr. Bachus.

Mr. BACHUS. I thank you, Mr. Chairman.

Let me—I will do like some of the other members and start out just with a statement.

I see an optional Federal charter is almost undoable from a practical and a political standpoint. I guess it is helpful to continue to discuss it. And I am not making any judgments as to what we ought to do, but I think as opposed to that, a much more practical approach is to identify some areas where we can have Federal uniform standards similar to what we have done on other legislation. And whether we pick those off, maybe speed to market, but I am not sure that we can do more than one at a time even, you know, market conduct, examinations licensing, and gradually take that approach.

But to me—and I read Mr. Fitts' testimony from Progressive on the second panel, and I would like—I mean, at least my impression is the same as his impression, that the idea of going to dual charter or creating a Federal insurance commission and assimilating all this is more than this Congress with other issues facing us is going to want to do. And from a State standpoint, I think that as a realistic matter it is just not something that is a burning issue.

Having said that, I am going to switch gears totally and just ask, Mr. Pickens, ask you about something quite different. Up here we have certain issues that people sometimes try to characterize as a trade issue. And one of those in the reinsurance business is your foreign reinsurers have argued to the U.S. Trade Representatives they weren't successful, that the collateral requirements that they had to put up, that that was a trade issue and not a solvency issue. And my concern is that I think it is definitely a solvency issue, and that they should have to—I know right now 100 percent collateral or either a State license.

And I would just like your comments on that. And I know that at this time the U.S. Trade Representative has ruled against Prudential, and which I think obviously is a correct ruling. But would you like to comment on that?

Mr. PICKENS. Sure, Mr. Bachus. I would be happy to. And first I commend you on really knowing about a fairly esoteric issue. You almost sound like an insurance regulator, and I mean that as a compliment, not a criticism.

Mr. BACHUS. A State or Federal insurance regulator?

Mr. PICKENS. No. State. State all the way, sir. But that is an important issue to us. It may be esoteric, but it is important. And what the Europeans are asking in essence is that they be allowed to create a special list that would have—I mean, it would be based supposedly on reinsurers that had the strongest financial stability, and they want to be able then to give Commissioners in the States the discretion to say, okay, Mister European Reinsurer, you don't have to have 100 percent collateral, you can have less than that.

There are some problems with that that we are working through at the NAIC even though we are under a lot of pressure from the Europeans to make a decision quickly, and we have resisted that because we think it would be wrong to do so.

Number one, this is a solvency issue primarily; it is not a trade issue. Could it impact trade and have ramifications? Ultimately, it could, but it is certainly more a consumer protection and solvency issue than it is a trade issue.

Number two, the three significant concerns we really have are, number one, the lack of international accounting standards. It is difficult to look at the balance sheet on this side of the ocean and compare it with that side of the ocean and determine the financial stability of a European reinsurer. We also have a problem in many European countries with enforcing United States' judgments against European reinsurers in those foreign courts. We get a judgment in a U.S. court, take it to some jurisdictions, you can't get it enforced. And the biggest concern really we have, Mr. Bachus, is A.M. Best and other rating agencies already have told the regulators that this will result in a greatly increased credit risk for our American insurance companies and American reinsurers, all of whom, by the way, are opposed. This is one thing they all agree on, they are opposed to reducing the collateral requirements right now. They think—the rating agencies say if we increase the credit risk that they will have to downgrade some of these insurers probably. At least that is something that would be taken into consideration.

So it is a major concern for us, and we can't make a decision prematurely. We really need to look at all these issues.

Mr. BACHUS. Thank you.

I thank the Chairman.

Mr. BRESLIN. I might also add, Congressman, that that has been—many of the issues that Commissioner Pickens discussed we have been discussing on an ongoing basis at NCOIL. And it isn't an either/or issue; as Mike Pickens said, it is one country might be very good in enforcing judgments and another might be a country that will never enforce a judgment of the accounting standards of the company. And it is just one that although we can pick out—we could all sit here and pick out a company in a country where it should be different, but it can't be an either/or situation.

Mr. BACHUS. I thank you.

Chairman BAKER. Thank you, Mr. Bachus.

Mr. Scott?

Mr. SCOTT. Thank you very much, Mr. Chairman.

While I agree that there are problems with the current regulatory system, I must say that, to each of you dealing at the State level, that there is one area in which I believe that the States have done an excellent job, and that is in consumer protection. I think at the end of the day that, to me, is the number one top priority.

State insurance Commissioners have done an excellent job in insuring that disputed claims are paid to policyholders. I worry that a distant regulator here in Washington, a Federal regulator here would not be as sensitive to consumers' needs as would a State or local insurance Commissioner. I have a fear that a Federal regulator who is dependent on the fees that carriers pay into the system would be more sensitive to the needs of the carriers than they would be to the consumers. Similar to the OCC, I could see an insurance regulator taking the side of companies over the consumers.

While I say all of that, this problem still remains: Largely as a result of September 11th, our tax cross-sector competition, increased loss costs, dwindling investments have indeed put the insurance companies in a bind. Issues still remain, albeit the protections that you give at the State level, which I support. But these

issues still remain of the concerns of the insurance companies, because clearly the consumer wouldn't—there would be no need for the protections if the insurance companies weren't there to provide the products and the services and the coverage.

But how do we modernize the insurance regulation? How do we secure your State-based reform? And the fundamental question: How do we increase the efficiency and uniformity of regulation and market conduct and oversight product approval and all of those things with 50 different States?

That is the sort of the bind that I am in here. While you do an extraordinary job of consumer protection, we still have these other issues of uniformity and regulatory efficiency that calls for us taking a look at this Federal regulator. How do you address those other concerns that would keep us away from the Federal regulator?

Mr. BRESLIN. I think we would first of all say that we are working on those concerns, producer licensing, speed to market, market conduct. And I think you are correct. We were chatting before that in our offices in the States, and we frequently ask this question, what kinds of calls do we get from our constituents—because we represent people in local areas—our constituents about problems with their insurance, whether it be homeowners or life, renter's insurance, car insurance. We don't get the calls, which is evidence that they are okay and they are being treated well, and that the insurance department in our State, represented by Superintendent Serio, does a great job. I don't think the Federal Government would be able do that kind of a job. And we are working on the other side to make sure that we satisfy the needs of the insurers.

Mr. PICKENS. Mr. Scott, in Georgia you really do have a very active consumer protector in Commissioner John Oxendine. We all know John, and he works with us.

Mr. SCOTT. Let John know I spoke highly of him and I called his name.

Mr. PICKENS. I will do that.

Mr. SCOTT. Because he is doing an extraordinary job. And as you can imagine, we did have a conversation beforehand. But I really think you are doing a great job on protecting.

You do not think that, to answer these other things on uniformity of efficiency and those things that we are asking for the Federal regulator to take a look at, that consumer protections would go down with the Federal regulator?

Mr. PICKENS. I think there is a danger they could go down if it was not handled correctly, and that is what we have been struggling with at the NAIC, and exactly how the chairman framed the committee hearing today, and that is that it is important to have strong consumer protection but you also have to facilitate business development and commerce in the marketplace. And I agree that the two notions are not mutually exclusive, and I believe all our members agree.

And just to answer your question though, Mr. Scott, I would point to the document that is attachment A. We have got a plan. This is our plan. We believe this plan takes care of consumers and also takes care of the legitimate concerns that the industry has raised.

Mr. SCOTT. What plan is that?

Mr. PICKENS. This is our reinforced commitment regulatory modernization action plan, attachment A. And it goes through all the five or six primary areas that I mentioned in my opening remarks and lets you know exactly what we are doing, what our deadlines are, where we are in accomplishing those deadlines. And, again, I would go back, Mr. Chairman. We appreciate the oversight, the attention you all are giving us, we appreciate the pressure. I think it is a positive thing; you have heard me say that before.

But one thing you could really help us with is putting some pressure on the industry to come play ball. We have built this surf stadium. Everybody hasn't come to play in it yet. We have got the National Insurance Producer Registry. Everybody is not willing to play. I wonder why that is. Maybe it is because they think they can get a better deal somewhere else. But if you help us hold their feet to the fire, I think we can make progress even quicker than we have made it so far.

Mr. SCOTT. Can you give us some examples of how you feel consumer protections would go down if we went to the Federal regulator?

Mr. PICKENS. Sure. For example, and all of our States have laws that say you have to have certain provisions in an insurance policy. We have got a law in my State that says you can't cancel or nonrenew somebody based solely upon the occurrence of a natural catastrophe or natural event like a tornado or hurricane. We passed that because we had a series of tornadoes sweep from the southwest part of the State through the central part of the State all the way up to the Northeast, and the next thing we knew we had insurance companies saying, hey, it is time to cancel these policies. They pay that claim, and then the next thing the consumer got was a non-renewal notice. That is an individual problem we had in my little State that our legislature had to address. And if we had a Federal regulator, I don't think they would have been as attentive to passing a law like that that deals with such a specific concern. That is a legitimate concern. This law doesn't hurt the companies, they can operate just fine with it. But now they have to find legitimate reasons to cancel or non-renew a policyholder rather than just saying, sorry, you had a big claim we had to pay and now we are going to cancel you. So I think that is a concrete example.

Mr. SCOTT. Do you think timeliness is another, the timing of the responses?

Chairman BAKER. And that will be the gentleman's last question, his time has expired. But please respond.

Mr. PICKENS. Yes, sir, I do. I think it is very important. And we all have laws, prompt payment laws with health insurance that relate to all lines of insurance that say a company has to pay claims within a certain period of time. And also the regulators are there to help work out any differences between the consumer and the insurance company, which I think is—you can't put a dollar value on that, which I think—that is that personal touch again.

Mr. SERIO. If I could finish a comment on this. There is almost a good analogy on this, and it actually would go back to Mr. Kanjorski's question earlier, and that analogy is how we respond to disasters or after a disaster, the FEMA and local emergency man-

agers, how they coordinate. We don't leave it to FEMA to do the work on the ground even though the Federal Government provides a lot of the money in the aftermath of a disaster. But the way that the emergency structure is set up, it is still left to the local emergency manager down to the local government or State government to really deal with those local issues. And that is what we do, and we do that best. And we are able to understand what the implications are, whether big disasters or small, big issues or small issues. But to get down to that localized level and having it closer to Main Street really gives an added value to the local constituents. And it really is that same kind of a setup where, just because the Federal Government does provide the resources, it is still left to serve the locals with the local managers, whether they are insurance Commissioners or emergency managers or any other type of analogy like that. And that has worked very well, and I think we are suggesting the same thing.

Mr. SCOTT. Thank you.

Thank you for extending my time, Mr. Chairman.

Chairman BAKER. Yes, sir, Mr. Scott.

Mr. Miller.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman.

To begin with, I want to say I don't support government getting in the insurance business. I don't think we should do that. I don't believe in total deregulation. But a lot of what I am going to say, you are probably not going to agree with. My favorite committee when I was in the State legislature years ago was the Insurance Company Committee, and 10 years ago I would never have thought a Federal charter was something that was needed. But I have somewhat changed my mind watching the way things have gone. Some of the comments arguing against that is, well, you could see a decline of State charters. Like banks, that could be true, but that doesn't make it bad. That just could be a reality.

One other comment was, well, it would probably take a long time to develop regulations for a Federal charter, and it is going to take some time, but NAIC has set up uniformed agent licensing regulations nationwide every year for 132 years, and it still hasn't happened. So I think we can beat that time frame right off the bat. I think that is something that is doable.

Another thing that I caught, we were talking about changing the system and the words we used, if we can get a reform—if we can get the reforms enacted by the States. But the operative word that stands out is "if." and that just doesn't seem to happen, because herding State legislators is like herding cats. I mean, to get all these different States going in the same direction is very, very difficult. And insurance companies just have this incredible patchwork of regulatory filings and approvals, and that really impacts the bottom line in the services and its cost based on delays, because equally important, it dictates the pace of developing new products. And that is something I think we need to be very, very careful of.

Even efforts to regulate uniformity consistently failed. I have not seen anything that makes me believe that if we don't have an optional Federal charter—and I say optional, because nobody is mandated to do it. But more than 3 years ago NAIC unveiled—you

called it a new modernization effort designed to improve State insurance regulations. But even then it wasn't new, because you have been talking about that same process since 1871, and the effort has yet really to prove to be successful. And I am not trying to be critical. Please don't take it that way. But I did read all your paperwork, and I have been looking at this issue very seriously for the last probably 4 or 5 years and I think it is time that we look at an optional Federal charter, because, Mr. Chairman, I don't think we really have much of an option but to do that.

By your own account, NAIC does not believe you can fully implement a compact—I read here on interstate compact attempts—until January 2009, and then there was a qualifier, at earliest. And that is your paperwork, not my paperwork. I think we can do a Federal charter by then, an optional Federal charter. I really do.

Chairman BAKER. Will your gentleman yield for one moment, just to make the observation. I had to go back and clarify, but that is with regard to life only. That doesn't include the broader insurance industry.

Mr. MILLER OF CALIFORNIA. So we are going to really get farther out, the time. I was giving them the benefit of the doubt there. We are getting farther out when we consider everything that is not even being considered right now.

Chairman BAKER. I just wanted to be helpful.

Mr. MILLER OF CALIFORNIA. Well, Mr. Chairman, I would really like to sit down and—we talked about this before. And I am from California, and I watch some of these States—and I am not trying to impugn the States, because everybody has the right to do what they want to. But they call them consumer friendly bills. And all it does is attempt to regulate the insurance industry, which is fine. But understand, any time you place a mandate on business, that cost is passed on to consumers. And some States for some reason don't realize that when they continually mandate that insurance companies must provide more and more and more and more and more, the people are going to have to pay for it, because you cannot mandate that businesses lose money. They are not going to do it. They are going to leave the marketplace. I mean State Farm Insurance almost pulled—they aren't writing any new policies in California, and they have about 20 percent of the policies.

This is a very serious issue. And I applaud all of you, because you have a real tough job. I mean, it is a nightmare. I can't imagine doing what you are trying to do and you have to do. But even when you come up with a concept that you believe will work, you have got to hope everybody agrees. And if they don't, there is really not much that can be done about it. At least with an optional Federal charter we can do something about it. And if we are wrong, if it is not good, people are not going to use companies that are using the optional Federal charters; they will use the companies that are a State charter. If the State charters can provide a better service, better rates, and the consumers are happier, they are going to stick with that. But if some of us are right and an optional Federal charter can come in with a program and they can do it quickly and rapidly and they can come in with new procedures and new programs that benefit consumers rapidly, instead of spending 18 months, 2 years as they try to implement throughout the States—

if that proves to be right, consumers are going to benefit, and if it is not right consumers will continue with the State charter.

So it doesn't eliminate options, and the part I am having difficulty understanding is what is wrong with creating another option? If competition is usually proved to be good, those who compete the best and provide the best tend to succeed. And years ago the Japanese auto industry proved that to our industry. You know, Chrysler and Ford and GM all took it for granted that everybody is going to buy American, and they created junk, and nobody bought it. And then when they had to compete, they created a product that people wanted.

Well, I think we are trying to create competition here, and you are kind of hamstrung in many fashions because you are asking States to do what you think is good and they can just turn their back and decide to do what they want to do and you really don't have any teeth.

So I am not trying to criticize you, I applaud you. I think you are trying to do the right thing. But I just think, you know, like in the time when they talked about optional Federal charters for banks, I am sure there is a lot of people saying, oh, it is a bad idea. I think it proved to be a pretty good idea, and yet there are still State banks out there operating today that can compete if they want to. And, yes, there has probably been a decline because you have seen Federal charters do a pretty good job.

And with that, Mr. Chairman, I thank you.

Mr. LUCAS OF KENTUCKY. Mr. Chairman.

Chairman BAKER. Mr. Lucas.

Mr. LUCAS OF KENTUCKY. I may be out of order, but I would like to completely associate with my colleague from California. I agree with everything you say, Mr. Miller.

Mr. MILLER. Lord love you. Thank you.

Chairman BAKER. Pass the collection plate.

Mr. Sherman.

Mr. SHERMAN. Ken, you don't know him like I know him.

Mr. HANNON. Mr. Chairman, can I make a comment?

Chairman BAKER. Certainly, Senator.

Mr. HANNON. You, both you and Representative Miller have rightfully referred to some comments in the NAIC testimony apparently about 2009. Having been part of the leadership of trying to get this compact together—and believe me, herding cats would have been easier—I do think that this committee needs to take note of the major achievement in doing that and the fact that it was only really adopted this summer. And legislatures have not been in session since then, so they have not even had a chance to have the bills introduced much less entertain them for action. It would be like someone asking you on December 1 why aren't you acting on the 2004 budget? It is not the right time yet. So I think there is a need to recognize that.

Second, NCSL has not put any deadline of 2009. We are looking to try to get immediate action and try to get people to address these issues. I would hope that we might—you have taken great leadership in these issues. I hope we might enlist you in that because of getting this adopted. There is a need. There is a need if you keep talking about other options, of people will say those other

options are more viable and the compact is not. I believe this compact offers some major good governmental policy. And so I just wanted to say, A, 2009 is not the NCSL number; and, second, we could use your help.

Chairman BAKER. And just a brief response, Mr. Miller. I would say that we are not in any way belittling the compact effort. We are appreciative of progress in any form or direction.

Mr. MILLER OF CALIFORNIA. Mr. Chairman, if you would allow me. I in no way intended to impugn anybody's effort. I think you are doing a wonderful job. I want to make that very, very clear.

Chairman BAKER. I think you did, sir. And all we are suggesting, I believe, is that whatever the deadline might be today in the agreed-upon, discussed, internal view of the various organizations, there is—and by way of record, Mr. Emanuel referred to our second hearing this year. We have had 11 in the last 3 years. We have been pretty busy on the topic. And it is symptomatic of members' interest to have some material progress demonstrated that affects rates at the consumer level. And whatever that time constraint is, that is really one of the issues that I raised at the outset is how long is enough time to get an appropriate response. I think Mr. Kanjorski's view in learning of the date of the compact was a bit surprised, and I think Mr. Miller's view basically is that it may be too long. And we are trying to be helpful here in saying that we can understand the clock is running and progress has been made, but we are trying to help speed it up a bit, is really the point.

And I am sorry, Mr. Sherman. You are recognized.

Mr. SHERMAN. Thank you. Mr. Chairman, my own experience is shaped by the Northridge earthquakes, since I represent Northridge. Some of you will remember that some of our consumers were not paid, that our State regulator found it unnecessary to impose fines on those insurance companies that made voluntary contributions to his foundation, when this led to that foundation putting on all these God awful commercials with this guy's face on them telling us that he believed in consumer protection and then his unceremonious departure from State government. This illustrates a few things. First, that you need regulation. Second, that State regulation doesn't always work all that well. It also illustrates the fact that whether it is tornadoes in Arkansas or earthquakes in California, when it comes to property and casualty there is a special sensitivity to different types of natural disasters, and that any regulator in Washington would have to be imbued with that sensitivity or defer to the States involved, although I guess we ought to have good tornado insurance provisions and rules in California notwithstanding the absence of any tornadoes.

Mr. Bachus brought up the idea that maybe we could have a Federal role take place in one area of insurance or another rather than try to do the whole package, and I am trying to understand what the different pieces might be that could be dealt with more or less separately.

It occurs to me that you have got the chartering of an insurance company which invariably involves dechartering them if they abuse consumers. You have got rating the solvency of that insurance company, which plugs again into their charter. You have got approval of different products, and life and annuity being the area where

you have the least local input. That is to say, we have earthquakes, you have tornadoes, but, you know, we have got heart attacks in both States. But you have got product approval, and then finally you have got agent regulation.

Are there other pieces in this puzzle that I haven't identified? Perhaps the Commissioner from Arkansas could tell me if I have left something out.

Mr. PICKENS. No, I think you have identified practically all of them, and I would refer you to our modernization plan that I think in great detail sets out our plan in great detail and, again, addresses each and every one of the points.

Mr. SHERMAN. Now, as far as agent regulation, I don't detect any push to have the Federal Government take that over, but I am less involved in this—I guess I am not supposed to ask the Chairman questions—but is there much effort here in our subcommittee to get involved in agent regulation, or is it more the company——

Mr. OSE. If the gentleman would yield, I think the principal thing is as much uniformity on all fronts as is practicable. Many agents now do so multi-state, and the more flexibility we provide—the traditional Republican response, the less bureaucracy we can have, the better.

Mr. SHERMAN. So that is an issue we need to look at. Is there general agreement that the life and annuity area is the area where there has been the most problems or disadvantages of having to go to each of the 50 States to get approval every time somebody comes up with some nifty new product to allow investors to avoid income taxes by investing in insurance?

Mr. PICKENS. To directly answer your question on that point, the pressure I guess from our own State insurance regulators from the industry is primarily aimed at the life insurance product approval process.

Mr. SHERMAN. That includes the annuity process?

Mr. PICKENS. Yes, sir.

Mr. SHERMAN. I might add, annuity should be called life insurance and life insurance should be called death insurance, but I never took a marketing course.

Mr. PICKENS. And the wait there. And the other issue is producer licensing, speed to market and producer licensing, and I would add a third——

Mr. SHERMAN. Producer licensing, is that agent——

Mr. PICKENS. Yes, sir, same thing. That includes agents, brokers and all involved, producers.

And then market conduct reform where we monitor and take action where necessary, the relationship between the insured and the insurer, and this goes back a little bit to your question, but you mentioned what I would characterize as kind of the politization of insurance in California from time to time. I mean, you have had some diametrically opposed theories of regulation in California, you really have. You have got Prop 103 that, you know, is at least a model that some of the nationwide consumer representatives like Mr. Hunter point to as being the model. I respectfully disagree with him on that point, because it wouldn't work in my State. But what would you have if you had a Federal regulator? The politics involved in insurance aren't going away, because, you know, we all

need health insurance, we all need life insurance, we need our auto insurance and homeowners. Folks are still going to be mad if their rates go up. They are still going to want to call somebody and get those problems taken care of. And I think you risk further politicizing the insurance business, which I think is a bad thing. I think that is a bad thing. I think you need to take politics out of regulation as much as you can.

Mr. SHERMAN. On the other hand, the idea of 50 different—doing a job 50 different times. Of course, there is not a lot of efficiency here in Congress where each of 435 offices does the same thing, but the idea that the same product needs to go through 50 different processes, as part of government that drives me crazy.

Mr. PICKENS. We agree with you. It shouldn't have to do that.

Mr. SHERMAN. And I was not here earlier, but I gather that the idea of this compact, should all the cats be herded, is to go through just one process for approving product or——

Mr. PICKENS. Yes, sir. We have got a single point of filing up and running right now, SERFF, System for Electronic Rate and Form Filing. Companies can file electronically. The average turnaround time right now through SERFF is 17 days, and we estimate 75,000 filings coming through that process this year.

That is currently available to——

Mr. SHERMAN. So we could just have hearings and pound the table and not ever do anything, and then inspire you folks to get your act together and be of great service.

Mr. OSE. And that is the gentleman's last question. His time is expired, too.

Mr. PICKENS. It has proven to be helpful, as the Chairman pointed out, yes, sir.

Mr. OSE. So you are doing good work, Mr. Sherman.

Mr. Inslee.

Mr. INSLEE. Thank you. You probably are pretty fortunate to be here this week when we had a demonstration of one of the most feckless regulatory performances in Federal Government history from the SEC. So you have come at the right time to talk about this issue. You are a bit fortuitous.

Our experience in Washington—we have got a great Commissioner, Mike is doing some great work. He has done great work on trying to protect consumers from predatory single-premium credit insurance, and it has really been rapacious in some circumstances. So we are kind of jealous of protecting that.

But I want to ask you as far as this effort, what should be the first goal of trying to have a more nationally uniform system? And what is the most difficult one to achieve that and still maintain State charter? That is a broad question.

Mr. SERIO. I suppose the goal is to come up with a system—and I think we have—that allows for uniformity across the States, like I think we have had based upon an agreement as to what that baseline should be and then allowing where a company wants to go into a particular jurisdiction and operate in that market, give them the most expedient way to operate in that marketplace where that marketplace may have some unique rules.

What has been the concern—and I will let the industry speak for itself—hasn't so much been that there is not uniformity, but there

is not even a baseline in most cases between—from one State to the next to the next for those that operate on a multi-state platform. But creating that baseline, creating that foundation of uniformity across the spectrum, and then going to the legislators and to the unique needs of New York or Washington or any other State, making it as effortless as possible for a company to operate within that market, where they clearly know what those specific rules are, not wide and varying deviations but those things that are just unique to that environment, giving them a pathway to do it in the most expeditious manner.

And that is the thing we have been focusing on in New York between leveraging technology, making it easy, transparency of process so that the companies know that they are not going to get questions at the end of the day, the so-called desk drawer rules or unwritten rules of regulation, and all the things that they used to complain about with respect to State regulation.

One of the curiosities in this entire discussion, both today and in the previous proceedings, has been that the things they complain about today have nothing—are different, and completely different than what they complained about 5 years ago. They complain about unwritten rules, desk drawer rules, 5 years ago and how they can't understand what is required of them in an individual State. So we lay it out, put it on our Web site, tell them follow these rules and you will get a product. And to this day, we cannot get the companies to follow those rules and get a product. They will not follow the rules that we lay out for them, that we will not deviate from, and that has been part of the frustration for us.

But I think the baseline, creating that uniform system of getting to product approval, getting to producer licensing, I think is the first step, and then we can go and talk about the individual and unique needs of the individual States.

Mr. INSLEE. What do you think, from what many in the industry would want to achieve, is the most difficult to do without a Federal charter?

Mr. SERIO. I think the most difficult thing to do without a Federal charter is—from their perspective—I think is that they want a rule to apply to all jurisdictions. And that is the challenge that I think comes back both to the subcommittee and to the committee and to the Congress as a whole: How do you change the rules? Do you do it by a matter of process where you simply say, okay, they can have a Federal license? Or do you have to affirmatively change the rules that they are currently operating under?

One of the challenges for us has been to work through the differences between the major markets. Florida, California, New York, Texas, Illinois have been the biggest market shares in the country, and we also happen to have among the strongest and most stringent rules with respect to this.

They would say, well, we want to get away from that, and then I think the biggest challenge would be how does the Congress then say the rule is going to be something less than they are already in the major markets where they are operating, and I think that is what they are asking for.

Mr. INSLEE. Thank you.

Mr. OSE. I thank the gentleman.

Mr. Royce, do you have questions?

Mr. ROYCE. Yes. Thank you, Mr. Chairman.

I wanted to ask Commissioner Pickens, first of all, in your opening remarks you mentioned that we should ask our constituents what they think about the Federal regulation of insurance, and I think that is a good idea. I frequently talk to constituents in my district, and they are concerned, because many of them have a very difficult time getting new homeowners policies because of excessive regulation in California, and major insurance companies just can't do business there right now. And I would ask, what is your solution for that regulatory problem in California?

Mr. PICKENS. Good question, Mr. Royce. Tell you what; California is a different market than the Arkansas market. I think that is one thing to point out. And it is difficult for me to sit here and say what would work in California just because it works in my State, because you all have particular problems that we don't; and, again, I think that points to one of the strengths of State regulation.

Californians to date, I mean, California passed Proposition 103. It was passed by a majority of the consumers out there, and from my standpoint—again, I know there are others, in our organization probably, and I know Mr. Germandi would disagree with this, but I think Prop 103 has resulted in a distortion of that marketplace, and that is a lot of the problem that was—but that is what people wanted at that level, and I just don't know how—if you passed a Federal law that is going to make Californians more happy.

Mr. ROYCE. Well, let me ask another question of our panel of witnesses here, and that goes to another aspect of this, and that is the fact that in business, firms like to have as much certainty for returns as possible before they go through the process of investing in new products. And in the current regulatory structure, why would insurance companies want to allocate capital to develop new products and then go through the process of hiring more salespeople or spend money on marketing if they can't sell those products on a national scale? It seems to me that is fundamental.

We are asking insurance companies to wait until 2009 for an interstate compact. However, they still do not have any guarantees that if they show that kind of patience they are going to be rewarded in 6 years with the ability to go through and market on that.

And so how is this process helpful for purchasers of insurance products, given the time line?

Mr. PICKENS. You mean the——

Mr. HANNON. If I could answer it, having done just from the NCSL standpoint, the compact, we did not put any impediment towards that compact being adopted sooner. We would hope it would. We recognize, especially when it comes to annuities—now that the market for annuities is recovering after a lull of 2 years, we would recognize that people need to have all of the elements that you rightfully outlined of certainty and being able to calculate their rate of return on investment, et cetera.

If you have a compact with a central filing, an ability to file at one place in product approval, then once gain that approval, sell in any of the States that are part of the compact, we feel it would be quicker than any other mechanism that could be adopted.

Someone estimated that just based I guess on their watching the States, it could be as late as 2009. That is not a view I share. I think that with an appropriate presentation, with the fact that the NAIC, in order to give people a sense of what the compact would be like, has established a working committee to come up with proposed rules, suggested rules, so people can take a look at it and not just buy a compact per se, but buy a fully fleshed out entity, something like that could be implemented much sooner.

Mr. ROYCE. Any other observations?

Mr. SERIO. Mr. Royce, you asked a great question, and I think you hit the nail on the head. That is really what we are faced with, whether we are talking about homeowners insurance or New York commercial liability after 9/11 or earthquake insurance or anything else.

You pretty much have summed it up like this. This is a question of how are they going to invest their assets, commit their assets to a particular State, when each of those States have differing challenges.

Part of the problem has been that a lot of insurance regulation had been built upon what you call rate regulation rather than cost regulation. We have said many times over, rate will follow the cost. You keep the costs of insurance down and the costs of the risks down, the rate will follow. But for many years that had always been rate regulation that we are going to keep the rates artificially low. Companies say I can't get enough of return, my capital costs too much, so I can't possibly operate in your jurisdiction.

I think we have gotten away from that. We have talked about competitive rating systems. So long as we keep an eye on the costs, unreasonable rules that increase the costs of insurance or the costs of covering those risks really is where the focal point should be.

As you have said, if you keep those costs under control, the capital will come in, because the companies are always trying to figure out where are they going to invest their assets next. We have a rule in New York pertaining to construction that is—that most companies won't even get into, because it is an absolute liability-type of standard. I am not saying yea or nay on that issue itself, but the answer we got from the companies was how could I possibly commit scarce capital to an absolute liability line of insurance?

It is a fair question. It has nothing to do with speed to market. It has nothing to do with producer licensing, but goes down to the very essence of whether a company can and will want to operate, whether it is in my State or any other State.

And that is what this really comes down to. If we make it competitive and profitable within reason for them, they will come in and they will operate in New York or any other State. And that is really the bottom line to this.

Mr. OSE. The gentleman's time has expired.

Mr. ROYCE. Thank you, Mr. Chairman.

Mr. OSE. Thank you, Mr. Royce.

Gentlemen, we do appreciate your participation in the hearing today. It has been most helpful. Our message is still pretty clear. I know we are making progress, but hurry up. Thank you very much.

I would like to ask our second panel to come up, and while you are coming to the witness table, make sort of an unfortunate advisory. I have been given notice by those managing the process on the floor that we can expect a series of votes probably beginning shortly after 5 o'clock that will be of some duration.

My request is—I know this flies in the face of fairness, having taken so long with the first panel—is that to the extent practicable, that if you can minimize your statement to a goal of perhaps 3 minutes as opposed to the traditional 5, we can get through everyone's testimony and actually proceed with committee questioning before we are interrupted.

It would be my intent that when the votes are finally announced, that the committee would conclude its work, because we are likely to be on the floor for about an hour, and I would not want to withhold each of you from your important business for an hour waiting on us to come back.

So with that advisory in mind, let me welcome Mr. John T. Fitts, Deputy General Counsel, Progressive Insurance Company.

Also state that everyone's written testimony, of course, will be made part of the record. And please proceed at your leisure.

STATEMENT OF JON T. FITTS, DEPUTY GENERAL COUNSEL, PROGRESSIVE INSURANCE COMPANY

Mr. FITTS. Thank you, Mr. Chairman, members of the committee. In light of the circumstances, I will certainly try to be brief and direct you to my written testimony which I think certainly lays out the essence of our position.

I talk to you from the perspective of a national group of companies that writes automobile insurance in 48 States. We are collectively the third largest writer of automobile insurance. We support the need for regulatory reform. Our concerns today primarily relate to the cost of the variance in State-by-State regulation, our ability to get product to market on a timely basis and adequately priced, and making the market conduct and financial examination processes more efficient.

If I can leave you with one thought, it is this: that insurance companies spend millions and millions of dollars dealing with regulatory and compliance issues, and most of that money is spent dealing with the variance that we find in State-to-State regulation. And so for national companies like Progressive, the notion of uniformity and consistency is absolutely appealing.

So this leads us to the question of can the State regulatory system deliver a uniform national regulatory policy that will help us cut costs out of our system and that will help us hold down the price of our product?

And much as we are supportive of State regulation and believe that it has a vital role to play in things like solvency and consumer protection, believe that it has value in being close to the marketplace and being able to help to address the periodic stresses that come upon our industry, we have great reservations about the ability of the State regulatory system to deliver consistency and uniformity on a 50-State basis. And primarily that arises from many of the comments that have been made earlier; that in the end, the

NAIC or NCOIL or NESL can recommend positions to States, but they really do not have the power to force States to adopt them.

And so we, like other companies, think about whether there are Federal solutions to this issue. We are not a proponent of optional Federal chartering, nor are we a proponent of federalizing the insurance marketplace, but we do see real opportunity in the use of Federal standards, which would preempt the field, not a floor but a floor and a ceiling both, which would be interpreted by the Federal courts, which would preserve the benefits of State regulation but at the same time provide the uniformity and consistency which I think will benefit consumers and will benefit our industry.

We are concerned that if we continue down the current path and the NAIC and the States are not successful, in 2 or 3 years there may be no stopping an optional Federal charter. It may be the only thing that—there may be consensus among at least the larger companies, the national companies and the regional companies, that this is the only approach that will really work. So we would encourage Congress to consider optional Federal standards.

In our testimony we raise agent and company licensing or producer and company licensing, market conduct and speed to market. I think that is a quick rendition of my testimony, and I will respond to questions later if you have any.

Mr. OSE. Thank you very much for your courtesy, sir.

[The prepared statement of John T. Fitts can be found on page 79 in the appendix.]

Mr. OSE. Mr. Jaxon A. White, Chairman and CEO, Medmarc Insurance Company Group. Welcome, sir.

STATEMENT OF JAXON A. WHITE, CHAIRMAN AND CEO, MEDMARC INSURANCE GROUP

Mr. WHITE. Good afternoon, Chairman Baker and members of the subcommittee. I am the Chairman and CEO of the Medmarc Insurance Group. This is a position I have held for the last 19 years. We are a small insurance company, 60 employees. We will have about $75 million in written premium this year.

My objective in the following comments is designed to educate and inform about the lack of uniformity among State regulatory mechanisms and how that really impacts a small property and casualty insurance company.

I would like to make some quick points about company licensing, rate and form filing and market conduct, because in my view the inconsistency of regulatory requirements from State to State is more than a distraction. It is a competitive barrier that disadvantages small insurers much more than large insurers.

We entered business in 1979 by partnering with a large insurer in numerous States. That large insurer issued the policies and they dealt with the regulatory compliance matters. For our part, we supplied that large insurer with underwriting and rating decisions. This is sometimes referred to in the industry as a "fronting" relationship.

That business relationship was far from ideal, but it was expedient, and it was necessary in view of the company licensing laws that existed in 1979 and are largely unchanged today.

Now, that is a perilous business situation, because we are a mutual insurance company, and we were wholly dependent on that large insurer for the benefit of their State licenses and their willingness to continue in business with us on a year-to-year basis. To become a completely independent company, we had to obtain our own licenses in all 50 States and the District of Columbia.

When we looked at the situation in 1993, it became so obvious to us that the State insurance company licensing system was a de facto barrier to small property and casualty insurers, and we needed a nationwide business opportunity, because our policyholders, both current and prospective, are found in all 50 States.

We were looking at a 5-year process to get licensed in all States. So we made a very important business decision. We decided that the only option for us at that point was to purchase an insurance company shell. We spent $3.6 million for the purchase of that shell, and that consumed about 10 percent of our net worth in 1995. That was necessary because we had to get into the marketplace on a national basis, and we understood from the very beginning that we have no disagreement with State company licensing laws. It is just a matter of are they consistently applied for large and small insurers alike.

Subsequent to purchase of that company, we found that we had difficulties in filing rates and forms. We use a form of coverage known as claims-made. Many insurance departments don't like that form of coverage. So we have had to manage to come up with several different variations on that. That makes our pricing, rating decisions difficult. It also impacts our profit planning.

In order to get around that issue, that is, to provide our policyholders where we find them in all 50 States with an option to buy coverage from us, we purchased another shell insurance company, in this case a surplus lines insurance company, which is then allowed in all States to have rates and forms without formal filing approvals. The purchase price there was $3.5 million. So now we are up to $7 million over about a 5-year period in order to acquire a national platform. Again, I don't quarrel against State sovereignty in insurance company licensing and in rate and form filing, but we sell a very unique commercial casualty product, and our policyholders are sued in all 50 States, but yet we have to deal with company licensing in all 50 States as well as rate and form. There is an inconsistency there.

Finally, I would stress on the market conduct area, we have found that there are enormous inconsistencies in market conduct. Large States and small States can be quite different in the way they approach the issue, and our concern here is that perhaps there might be one area—and we are proponents of Federal standards—I can't describe them for you, and I am sure members of the company cannot enunciate them right now, but it may well be that Federal standards could help us with one principal area to start with, market conduct or perhaps with insurance company licensing.

That is a very quick summary of some written testimony that I have supplied to the committee, and I would be happy to respond to your questions.

Mr. OSE. Thank you very much, Mr. White.

[The prepared statement of Jaxon A. White can be found on page 159 in the appendix.]

Mr. OSE. Mr. William B. Fisher, Vice President and Associate General Counsel, Massachusetts Mutual Life Insurance Company. Welcome, Mr. Fisher.

STATEMENT OF WILLIAM B. FISHER, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY

Mr. FISHER. Thank you, Mr. Chairman and members of the subcommittee. I offer my testimony today from the perspective of one of the largest life insurers in the country marketing national products on a nationwide basis.

Modernization of insurance regulation is one of the most critical issues facing both Mass Mutual and the entire life insurance industry. Increasingly, we compete with competitors who operate under far more efficient regulatory systems. The inefficiency and the lack of uniformity permeates virtually all aspects of insurance regulation, with the most pressing concerns being the issues discussed earlier.

Our customers ultimately bear the cost of inefficient regulation. When we are not able to offer the latest and least expensive version of a product because a State has not approved it, our customers lose. Inefficiency also translates into lost opportunities and duplicative effort.

For 2002 alone, we estimate that we lost up to $60 million in sales as measured by premium, due to our inability to bring products to market in a timely manner. Due to differing State requirements and interpretations, it is common for us to have anywhere from 30 to 40 versions of a given product in the States.

Further, in the past 5 years, Mass Mutual has undergone 14 separate State market conduct examinations, which is 13 too many.

Mass Mutual commends the State regulators and legislators for their very good-faith commitment and dedication of extensive effort toward regulatory modernization, as evidenced by the original NAIC statement of intent in March of 2002 and their more recently released action plan.

The action plan sets forth a very ambitious agenda to modernize State insurance regulation. Given the basic nature of a 50-State regulatory system, however, we doubt the ability of the States to accomplish the comprehensive uniformity and regulatory efficiency that is sorely needed.

In our 50-State system where each State is responsible for protecting its residents, there will undoubtedly continue to be differences among the States on how best to accomplish that job, thereby undermining the unprecedented collaboration in home State deference called for in the action plan.

The action plan also calls for enactment of legislation in the States, which introduces yet another level of political complexity. On what is perhaps our most pressing issue, inefficient and disparate regulation of product, the action plan falls far short of the mark, with a goal of only having 30 States by year-end 2008.

Mass Mutual supports congressional enactment of optional Federal charter legislation for insurers. This legislation will provide

strong consumer protection by establishment of requirements as strong as those found in the States, including adoption of continued regulation of life insurance products. Optional Federal charter also represents the most immediate and best means of accomplishing comprehensive uniformity and efficiency, since it calls for a single regulator and a single set of standards for Federally chartered carriers.

Finally, an optional Federal charter will provide the needed Federal insurance regulatory presence in Washington that again was discussed earlier.

I appreciate this opportunity to testify before you.

Mr. OSE. Thank you very much, Mr. Fisher.

[The prepared statement of William B. Fisher can be found on page 68 in the appendix.]

Mr. OSE. Next witness is Mr. Tom Ahart, President, Ahart, Frinzi & Smith Insurance Agency. Welcome, sir.

STATEMENT OF TOM AHART, PRESIDENT, AHART, FRINZI AND SMITH INSURANCE AGENCY

Mr. AHART. Thank you very much. I would first like to say that Ron Tubertini was supposed to testify originally as an agent from Mississippi. I am a good friend, have worked with him with the testimony. Unfortunately he couldn't get out of Mississippi on his flight today. They were all canceled. So I was called and drove down from New Jersey because I worked with Ronnie on this. So the testimony we submitted would be my testimony as well, and I will give a summary on that right now.

I am President of an insurance agency in New Jersey. I am currently licensed in seven States, and I think in all of the testimonies that I have heard today and in other days, there has really been agreement that there have been a couple major problems in the current regulation—State regulation. And number one would be the licensing issues; number two, the speed-to-market issues. And we would agree with that—with everyone else that there are major problems right now that need to be addressed.

I think when I look at the ways they can be handled, I hear people say we could continue to be State regulated or we should shift completely to some kind of Federal regulation or optional Federal charter, and I would like to talk about both of those for a minute and then give my own ideas of the different way.

First, on maintaining State regulation, I have been—always been a big proponent of State regulation, mainly with consumer issues. I think being an agent gives us a pretty good perspective to talk about these things. I work with insurance companies all the time. I know the problems that they get into, the problems that it causes us. I know the problems that as agents we have from day to day, and I know our consumer problems and what they complain about.

So I think we have a pretty good perspective, being down in the trenches, of exactly what is happening out in the marketplace. And I would say that I have worked very closely with the NAIC, and I would commend them on their new action plan. However, on one side as I commend them, you know, I think they are trying—and I think in the last 5 years especially, they have made big improvements as to where they have come in being able to get some things

done; but the fact of the matter is that things like producer licensing, for instance, they—even though they might have 41 States currently complied with Gramm-Leech-Bliley, that doesn't help me with the other 9 States and it also doesn't help me that on paper they are complied with, but yet when I try to get a license it doesn't work quite as easily as they have said.

So uniformity and reciprocity has been a problem, and my problem with some of these issues being solved at the NAIC level is that they really don't have the power to make all the States comply, so they really can't guarantee uniformity. And I think, for example, it is an issue that needs to be done anymore with changes in the global marketplace, increases in technology. I have a lot of insureds that all of a sudden, instead of just having a business in New Jersey, they have a sales office in Georgia or in Maryland or in Massachusetts or Arizona or wherever it might be, and that is not unusual anymore to have that. And as soon as that happens, I have to be licensed in every one of those States in order to get them the proper coverage for those offices. And what I found is it is not nearly as easy as people say. In the last 6 months, as a matter of fact, we have had to be licensed in three additional States.

One State, I can say it worked great. They used the national database. We filled out a form on the Internet, and within 2 weeks we got our nonresidence license. Another State, it took 6 months and was just constant paperwork, constantly sending stuff back to us, and our insureds were upset because we couldn't help them. I had to make them get a different agent in a different State which they didn't like.

So there clearly are problems. I don't see how the NAIC, no matter what kind of plan they came up with, can change that if they can't mandate all their States to act.

As far as Federal regulation goes, my problem with that is that it is complete overkill. In all the issues I have heard, it mainly is involved with licensing. It is mainly involved with speed-to-market issues. And the problem—and we can correct those problems in other ways without changing the whole State regulation system. And, you know, it has been mentioned that consumer protection is a great big plus for State regulation. Well, why would we go to something that is completely unknown in order to change that?

So Federal regulation it will be—I have worked for 20 years as an independent agent and have been very involved in the association, the Independent Insurance Agents and Brokers of America, and they have come up with a proposal that I think is a middle-ground, pragmatic approach which allows us to keep State regulation and all the good things that they do; and in those issues that can't be helped by State regulation, like speed-to-market licensing, we use Federal legislation, not regulation, but Federal legislation to pass laws that would actually create standards that States would have to comply with, not minimum standards.

I mean, some people misconstrue, I think, what the bill is about, but it would be actual standards that States would have to comply with and it would create uniformity and reciprocity. And that could be handled as issues come up on an as-needed basis and not create all the problems with having a new Federal bureaucracy that has things that is completely unknown.

So from our—from my proposal, I would just say that, you know, I believe in State regulation; but in those areas where it didn't work, we should use Federal legislation and preempt State laws.

Mr. OSE. Thank you, Mr. Ahart.

[The prepared statement of Ronnie Tubertini who was represented by Tom Ahart can be found on page 148 in the appendix.]

Mr. BAKER. Our next witness is Mr. Neal S. Wolin, Executive Vice President and General Counsel for the Hartford. Welcome, sir.

STATEMENT OF NEAL S. WOLIN, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, THE HARTFORD

Mr. WOLIN. Mr. Chairman, thank you very much. Members of the subcommittee, it is a great pleasure to have been asked to provide some views on how Congress might reform insurance regulation.

As you know, insurance has become a multibillion-dollar industry, and it is our view that the present structure of regulation adds unnecessary costs to insurance products and restricts our ability to meet consumer preferences.

There are really three areas that seem most critical—most critically in need of modernization: forms, rates and solvency.

With respect to forms, insurance companies must file forms for each of the product lines for which they seek to operate and in each of those jurisdictions in which they seek to operate. And for us as a national carrier, that means filing forms in each of the 50 States and the District of Columbia. And each of those jurisdictions have different standards for form approval.

For us, for example, on the property and casualty side we file 5,500 forms a year, and on the life side another 2,500 forms. This elaborate process is an enormous burden on us and on the rest of our industry, but most importantly, we think has negative effects on our ability to serve consumers.

First of all, consumers ultimately pay the cost of our compliance with this regulatory burden. In addition, the complexity of the process interferes with our ability to bring new and better products to market.

With respect to rates, the insurance industry is marked by robust competition, competition which we think should and can establish prices at the most consumer-friendly levels. Government price controls often distort the connection between risk and price and often ultimately hurt the consumer or lead insurers to withdraw from the market. Our view is that price controls should be used as a regulatory tool only as a last resort and only after market-based efforts have failed.

With respect to capital adequacy, addressing rate and form concerns obviously doesn't mean ending all regulation. Strict solvency regulation is also needed to protect consumers from underpricing by companies willing to collect premiums now and avoid paying claims later by declaring bankruptcy. When States force companies to remain in markets and sell products at artificially low prices, companies flounder, State guarantee funds are forced to pick up the pieces and pass on costs to consumers, taxpayers and, more specifically, to insurance policyholders.

Nearly 20 years ago, Mr. Chairman, a predecessor of this committee investigated the ability of State regulators to perform the twin missions of company solvency and consumer protection. The subsequent report and hearings produced headlines on deficiencies in both areas.

Since then, the NAIC and many active individual Commissioners have strived in good faith to improve consistency, quality, efficiency and speed. Notwithstanding their good faith, however, the actual reforms have been too slow in coming. In fact, the NAIC's new action plan adopted less than 2 months ago echoes many of the initiatives announced and pursued over the past two decades. The plan strives for greater standardization and speed, but leaves the State structure and its multiplicity of rules still in place.

At this committee's initiative, the GAO recently studied efforts of the States and the NAIC to streamline and modernize market conduct. The GAO study cautioned that it was uncertain not only when, but even whether the NAIC and the States could accomplish this goal. We share that concern and believe that any plan which lacks uniformity and consistency will not produce the modernization necessary for our consumers.

The Hartford believes that the solution that best provides value to consumers and the economy overall is one that grants national insurers the level of Federal oversight offered to other large financial institutions. We believe that Congress should develop legislation permitting companies the option to be chartered and regulated at the Federal level. Policyholders, claimants, and taxpayers will all be well served by regulation that is standardized, efficient, and time sensitive.

And the key word here is optional, Mr. Chairman. If some State, regional, or national insurers believe that their customers in the marketplace will be better served by State regulation, they should have that choice.

Thank you again for the opportunity to appear today, and I would be delighted to answer any questions.

Mr. BAKER. Thank you very much, sir.

[The prepared statement of Neal S. Wolin can be found on page 164 in the appendix.]

Mr. OSE. The next participant is Mr. Markham McKnight, President, Wright and Percy Insurance, but, more importantly, my constituent. Welcome, Mr. McKnight. Good to see you, sir. Hope you are happy and things are well.

STATEMENT OF MARKHAM McKNIGHT, PRESIDENT, WRIGHT AND PERCY INSURANCE

Mr. MCKNIGHT. Things are well. It is good to see you as well. Thank you.

Thank you, Mr. Chairman, for this opportunity and for your hard work on these issues. I am President of Wright and Percy Insurance in Baton Rouge. We are one of the largest insurance brokerage firms in Louisiana, providing an array of products to corporate individual customers.

Earlier this year my firm was purchased by BancorpSouth, a large financial institution based in Mississippi which currently operates insurance agencies in three States. This marriage is a reflec-

tion of the huge consolidation and convergence of the financial services industry, not only nationally but internationally as well, particularly on the insurance agency brokerage side.

Today, more than 80 percent of all business insurance premiums placed in the country are brokered by 250 firms. There was a time when those in my ranks fought bank insurance affiliations, but as a result of the reforms that Congress created through Gramm-Leach-Bliley, today we are finding we have a more competitive and a fair marketplace for the sale of financial products.

I want to associate my remarks with Mr. Fisher and Mr. Wolin with respect to urging you to look toward the dual banking regulatory option as a model for treatment of the insurance industry. While no system is perfect, it is clear to almost everyone in the banking industry that their system has created a healthy competition among regulators and has enabled banks to operate across jurisdictions and introduce products in a far more streamlined way than our insurance system. And I don't believe there is any evidence to suggest that 90-some-odd regional offices of the OCC are any less responsive to consumers than the 50 State-chartered regulators.

I believe that it is critical to the long-term viability of the insurance industry that Congress pass legislation creating the optional charter. There is also a more immediate need, though, for forms that can't wait for the resolution of the Federal charter debate.

NARAB is an excellent template for Federal intervention and has had very good results. For decades NAIC has attempted to streamline the agent-broker licensing system with only modest achievements, results that were frankly outstripped by the pace of interstate and international convergence.

The NARAB provisions gave the States 3 years to create licensing reciprocity and threatened a national license clearinghouse if they failed to do so. Many States responded positively to the threat of NARAB, and today the majority of the States have passed the model producer licensing statute, New York being the latest. Yet the NAIC's testimony here today does not even mention NARAB as the reason for these advances.

Additionally, a Federal court has recently ruled that the countersignature laws, one of the last vestiges of protectionism in the States, are unconstitutional.

The task on agent-broker licensing reform is unfinished, and we think that the goal should be 50-State reciprocity or uniformity. Nine States, including two of the largest, do not have reciprocity. Additionally, NARAB only addresses individual licensing and not agency licensing. We would encourage you to take the next step to that end, and we don't think this goal can possibly be met without Federal intervention.

There are some other problems that deserve immediate attention that could also be stepping stones to the path towards the optional charter. Some studies have shown that it can take as much as 2 years for a new product to be approved for sale on a nationwide basis. Banking and security firms by contrast can get a new product into the national marketplace in 30 days or less.

Congress should address these problems by establishing some sort of NARAB-like incentives to encourage States to bring their speed-to-market initiatives into harmony.

In conclusion, I strongly agree with your statements that Congress needs to consider short-term and long-term solutions. With need State-based reforms. We need continued Federal oversight and pressure to reach uniformity in State laws, and we need you to continue laying the foundation for an optional Federal charter.

I urge this subcommittee to begin work now on those reforms that are easily attainable in the short term, such as further producer licensing reforms, speed to market, and increased access to alternative markets as well as the long-term reforms that may require fuller examination and debate before enactment. Thank you.

Mr. OSE. Thank you very much, Mr. McKnight.

[The prepared statement of Markham McKnight can be found on page 99 in the appendix.]

Mr. OSE. Thank all of you. That was a stellar performance to give those six statements in that record time. For what it is worth among the members still here, that scores a few points.

Let me start with what I consider to be obvious low-hanging opportunities for some improvement. If we are to assume that a new Federal building on K Street filled with employees may take a while, it seems that NAIC and their compact and NCOIL with its models have, at least at the national professional level, adopted some platform of enhancements which experts in the field agree are responsible. Their difficulty is they cannot unilaterally impose those recommendations on their membership, and they are then reliant on State legislatures to act in accordance with those practical recommendations.

If we were to take the models of NCOIL, the elements of the compact, put it together in a sack and give a clock by which those improvements must be considered adopted at the State level to establish basically uniformity without a national charter consideration, is that a significant enough improvement from the various perspectives at the desk to warrant the effort to do that? And I will make the obvious caveat. There are some who feel that if we act at all, that then the inertia to move further goes away for a while.

Other members can speak to that, but from my perspective, I think this is going to be a continual ongoing effort for some years to come. I don't think we can get a bill done in a short period of time that is a universal solution. I do believe we can get to a universal solution, but I think we have to demonstrate that the elements that many proponents of the national charter indicate can be validated by taking progressive steps.

Now, whoever wants to jump in, please do. Yes, sir.

Mr. WOLIN. Mr. Chairman, it is, clearly, from our perspective, not and all-or-nothing question. We have been working with the NAIC and will continue to do so on reforms.

I think that the goals that you have mentioned, the compact and other things, are certainly laudable goals, and if implemented as expressed would be meaningfully better than the current circumstance.

Having said that, I think that it is going to be a long time in coming, some of these things, and even if the Congress were to put

a clock on it as you suggest, it still leaves the possibility, maybe even the likelihood, that you will have 51 different jurisdictions interpreting a Federal law in all kinds of ways.

I would note that for NARAB, for example, 3 years on, we still have at least a third of the marketplace not affected, and also a number of States still with different rules, slightly different rules, but nonetheless creating a burden for those of us who want to operate in all of the jurisdictions of the United States.

So I guess my bottom-line answer is that we would want to continue to work with Congress and with your subcommittee, as well as with the NAIC and others, but I think we are skeptical that those kinds of sort of partial solutions will really get to a place where we will be operating with the effectiveness and the efficiency on behalf of our customers that we would like to be at.

Mr. OSE. Mr. Ahart.

Mr. AHART. I mean, I would agree, Chairman, with you completely, except I would say have no clock. I believe in reciprocity and uniformity completely, and I think that it needs to be established where States just have to do it. And, you know, the argument that, you know, States are going to interpret it differently or anything like that, we have 50 different States right now, and they interpret a lot of things differently that the government does. But that all gets done, and so I don't think this would be any different.

Mr. OSE. Yes, sir.

Mr. MCKNIGHT. I would like to add that—kind of put it back in your terms, that if we put all these things in a sack and shook them around I would suggest, all due respect to the NAIC, being the hard—the NAIC and the hard work and effort that they have put in the last several years—nothing has come about with the NAIC unless there has been Federal intervention at this point in time.

I would suggest that the compact would be a bottom line, nothing more than a confederacy of States, with no one being held accountable at any point, place, or time.

If you want to look at some of the direct issues—and you said pinpoint some issues that you would approach—I would approach the uniformity and the licensing in the 50 States. That effort very frankly—because they have 41 States—that effort is complete by the NAIC. It is complete, but it is not a win. Although we have 41 in compliance, the remaining jurisdictions have a significant percentage of the property casualty premiums out there mainly coming to California and Florida.

So the 3-year time period with the incentives that were in place with NARAB seem to work pretty well, and I don't see why there couldn't be a follow-up with like-kind incentives and put a 3-year time period on it and push through the reciprocity, address the speed-to-market issues by possibly limiting the preapproval systems that are in place in the States. And at the same time, I would also push for the alternative market solutions.

Mr. OSE. Well, I appreciate that, and I am tending more toward uniformity than just reciprocity. Reciprocity still presents redundancy problems in meeting this 3-States' requirement or that 3-States' requirement. I think if we don't shoot for uniformity, we are

going to wind up with a significant remaining hodgepodge at the end of the day if we make progress.

Mr. MCKNIGHT. I agree with that a hundred percent.

Mr. OSE. Mr. Fisher.

Mr. FISHER. A few comments on that. I worked very hard on the interstate compact with the NAIC, and also testified three times before Senator Hannon's committee at the NCSL. I am pretty familiar with it.

I think there are a number of things we have to look at with respect to the compact. First of all, it is, as Senator Hannon indicated, a compromise document. That being the case, for example, a State may join the compact by enacting legislation, but it still retains within the right—within its rights within the compact the right to opt out of product standards on an individual basis.

We basically said, okay, we can go along with that on the theory that everybody is going to be operating in good faith, and we hopefully will not see too much of that.

I think a more subtle concern has to do with the provisions of the compact that supersede conflicting State law. After a very long political process, those provisions were limited only to product content requirements, and that seems like it is the logical thing to do, but it is very difficult. And the NAIC is seeing this in connection with the standards which are being set right now, that it is very difficult to discretely excise a piece of State regulation in the product arena away from some of your market conduct laws, because the two are very heavily interdependent.

So there are a number of challenges, but more importantly, I think I would just make the observation that from my company's perspective, we are really looking for comprehensive uniformity and efficiency of regulation, not on an incremental basis; and in our view, the Federal charter is really the only way of getting there in an efficient fashion. And we have—I testified 2 years—over 2 years ago before this subcommittee, and we are now—what we have is a failed CARFRA, an interstate compact that hopefully will be passed in the States, but the NAIC says it may only be 30 by the end of 2008.

Mr. OSE. Mr. White.

Mr. WHITE. In 1981, Mr. Chairman, this Congress passed the Products Liability Risk Retention Act. It further strengthened that law in 1986, and it did that so that it was a market-based solution, that being that one State could then control the fortunes of an enterprise that wanted to sell its products in 50 States.

There was a certain amount of resistance among State insurance Commissioners, but you could see as that process unfolded that there was a Federal mandate there, that there was a law in place that they could consult, and although the NAIC did a nice job in coming up with handbooks and interpretive works, it still was a bit of a challenge over time to overcome the State's right philosophy. Yet the Federal Government knew in its full justification that that law had a specific purpose to solve a specific market-driven opportunity, and many of those organizations exist today and satisfy a variety of product needs and consumer needs. And yet they are not regulated by 50 States.

So it is just an illustration I would bring to your attention.

Mr. OSE. Thank you.

Mr. Fitts, did you——

Mr. FITTS. Yes. I might as well jump in. Everybody else has commented.

As a property casualty company, we really have no opinion on the compact. You started out, though, with an example where we bundle up a group of NCOIL model acts and we throw them out to the States and say you have got X number of years to act on these.

I have a couple of comments about that. I don't think what you are saying is the same as NARAB and NCOIL—excuse me, NARAB and GLB. That didn't work for a couple of reasons, one of which you really put your finger on, and that is that it didn't really press the uniformity. And in the end uniformity is where we are ultimately going to gain the cost gains that are going to be able to make us more competitive.

I am also a little bit concerned about the notion of just wrapping together model laws from NCOIL or the NAIC. I think that it might make some sense to slow down, for Congress to identify the areas which it wants to address and then reengage both regulators, consumers,and insurance companies in determining what might be the best model, the optimal model, for insurance regulation as opposed to taking something that may have been done 2 or 3 years ago, that was never done as a national standard, and give us an opportunity to be a part of the deliberative process.

But I do agree that we need to be careful, to move slowly so there are no unintended consequences and so we do this right.

Mr. OSE. If I may, I am going to recognize Mr. Lucas, and if Mr. Shays wants to get in before we have to go vote.

Mr. LUCAS. I will be brief, Mr. Chairman.

I listened to all the testimony today, and, you know, I can understand why property and casualty people would want to be held at the State level and regulated. I understand that totally. But as being in the insurance business for 30 some years and going through the frustrations of trying to deal in three States and more at times, again, the speed to market was really a major, major issue. I can appreciate the fact that the people from the States, you know, there are some jurisdiction protections. We understand that fully here in Congress about protecting our jurisdictions, but I really have a difficult time seeing why the optional Federal charter does not work well where people choose to utilize that.

You know, the consumer wins because, let's face it, any new additional cost always goes to the bottom line, and in a competitive situation—and our insurance companies are all going to be competitive—who is going to win here? It is going to be the consumer. And I think we need to look out for that.

So I really don't have any questions other than I am still not convinced that having the ability for an optional Federal charter, particularly for the life companies, isn't the way to go. Thank you.

Mr. OSE. Thank you, Mr. Lucas. Mr. Shays.

Mr. SHAYS. This is not a hearing that—I only have had 3 hours of sleep, given that I was watching elections last night back in my district and not liking the results.

But I am wrestling with the bottom-line fact that I feel that the message is if you really want proper oversight—I mean, in the whole hearing—it has got to be done by States, because the Federal Government can't do the oversight. It is going to take a long time either way, and I think that it is impossible ultimately to be a competitive industry if you have got to work with 50 States.

And so I would like to know how I can see quick action that enables our companies to be competitive internationally and not having to have so much stupid paperwork throughout the country. I mean, it doesn't make sense to me ultimately. It seems to me like it is just a practice that existed for a long time.

So I understand, you know, as we look at it, three or four Federal, a dual system, and all of you would like some Federal action. But I guess the question I want to ask is why does it have to be this way? Why do we have to have this kind of bait? Why does it take so long? Why does it have to be this way in this day and age?

Mr. MCKNIGHT. I don't think it has to take that long. During the first panel's testimony by Commissioner Pickens, he referred to the nationwide filing and how that was going to solve a lot of the problems, being able to file at one point and move forward. And while those filing efforts may be more efficient, it still does nothing to speed the preapproval processes that go on in every State.

So I agree with your comments in that regard and I don't think that is being properly addressed in the compact that is being put forward. I think that does have to—I think that is a stepping stone. When you address speed to market, it is a stepping stone to Federal chartering.

Mr. AHART. I would just like to say that I think there is an easier way to do it, and that is to use the Federal laws approach, the Federal tools approach, to handle speed-to-market issues. For instance, you could have a Federal law where, you know, forms are filed and used in 30 days. They are approved after 30 days. If they are not——

Mr. SHAYS. Even under a State-chartered system?

Mr. AHART. Yeah, because I think what is happening is you are doing Federal laws which the States would have to comply with. So right now you have a political system in 50 different States where they don't all listen to the NAIC, and for their own political reasons they do certain things, but for the most part the State regulation works very well.

So those areas where it doesn't work well, like in speed-to-market issues or in licensing for one reason or another, you pass a Federal law where they have to comply, and it takes it out of the political arena at the State level. Yet the States could still actually regulate it and make sure that it is complied with.

Mr. SHAYS. Give me the best argument against that.

Mr. FISHER. Perhaps I can help there.

First of all, on the light side at least, a lot of States have those so-called "deemer laws" and they have not worked all that well, partly because companies are not all that willing to take a so-called "deemer approval" if they have not heard from the State within 30 days.

In many cases, the regulators view the deemer approval as not being real approvals and feel they can talk to you after the 30 days are up.

I can give you an example for my company and my industry in my home State many years ago. Our deemer law has been in effect as long as I have been with Mass Mutual, which is over 30 years. We had a Commissioner who had a pet peeve on something.

Mr. SHAYS. A what?

Mr. FISHER. A pet peeve. I do not remember what his issue was.

For a year and a half every product filed was automatically disapproved as being in violation of the law. That was it. No company could get any product approved in that State.

So I am not sure the deemer laws really go far enough, but more importantly, they also do not achieve uniformity. They really go to the process of filing, not to the substance of the contract.

Mr. SHAYS. Yes, sir.

Mr. AHART. The filing use was an example; it could be whatever the Federal law deemed to be done to be the best law possible. So, you know, I would say the one problem with the argument, you know, about how it is done in certain States right now is, if you had a Federal regulator, which was the State he was talking about, and then they disapproved everything for everybody, you would be in a lot worst case. There is nothing to show that the Federal regulator would be any worse or any better than the State regulator, so instead of creating another level of Federal bureaucracy, you are determining what the best possible solution is and then creating uniformity by passing that and making all comply.

Mr. SHAYS. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Shays.

Let me make a request for a slightly early Christmas present, and let me restate my initial observation and not just the NAIC compact, but the NCOIL models that they outlined—even the one they hadn't yet adopted, if that is publicly available.

You bundle all of that, can each of you from your various perspectives, if you choose to comment, give us something which indicates where those generally agreed-upon reform principles are deficient from your perspective? And what other additional reforms might you consider if we were to consider within the Congress the adoption of a proposal that would have immediate operative effect?

Take that for what it is. It is a request for you to analyze what the State leadership has come up with their offer; and we, as a committee, need to understand where that State offer is deficient if, in fact, it would be by combining them all.

It would seem to be in just making a public debate here with NAIC and the NCOIL folks, and my question to that panel in fairness was: Why can't we do what you recognize nationally instead of waiting on the legislative bodies to act voluntarily; and the response wasn't particularly strong, and I got the response, no Federal action was the goal.

I am suggesting that Federal action might be appropriate, but if we use the recommendations the State professional organizations have contemplated themselves—if they are, in fact, reasonable—that would seem to be persuasive with many members of the committee.

But I would like to request, you know, by the middle of December perhaps, you know, take a month, if you could get something back to the committee for us to consider as a response to that, it might be helpful. And then for those who are advocates of the national Federal charter, which I recognize, please give us the reasons why you think that approach is not responsive. And we'd be happy to get that.

I am reaching no conclusions here. I am just asking for professional help to analyze what is out there on the table from the various perspectives, to see if we cannot get the committee to come forward with something in the next session of the Congress, whatever that might look like, making no judgments, making no proclamations.

I am not suggesting we have a bill. I am just talking to my friends in private, so—which, of course, you will read about tomorrow.

And let me express my appreciation to you. We are down to just a few minutes remaining on this vote. As I indicated, we have a series of votes that will keep us about an hour. I wish we had more time; I regret this has happened, but at this time I have to state, our committee hearing is now adjourned.

Thank you, gentlemen.

[Whereupon, at 5:32 p.m., the subcommittee was adjourned.]

A P P E N D I X

November 5, 2003

November 5, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Hearing entitled, "Reforming Insurance Regulation – Making the Marketplace More Competitive for Consumers"

Thank you, Mr. Chairman, for calling this important hearing. I am very interested to hear from our distinguished witnesses, today, on the National Association of Insurance Commissioners (NAIC) initiatives to modernize insurance regulation at the state level.

I look forward to a more detailed discussion of the NAIC's "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan," and related progress on the issues remaining in the insurance industry. In my home state of Ohio, we're very proud of the work our Director of the Ohio Department of Insurance, Ann Womer Benjamin, has done to explore modernization of our state structure.

Accordingly, I also expect a full discussion with our second panel today regarding the specific areas of state insurance regulation that the industry feels are most in need of modernization, the current progress of reform efforts, and, of course, the possibility of an optional federal charter or targeted federal legislation to promote state uniformity.

Thank you again, Mr. Chairman, for bringing us here this afternoon to continue our discussions on reforming insurance regulation and addressing the areas that remain in need of reform.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON REFORMING INSURANCE REGULATION: MAKING THE MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

WEDNESDAY, NOVEMBER 5, 2003

Mr. Chairman, we meet today for the second time in the 108th Congress to consider insurance issues. Today's hearing will focus on the latest modernization efforts announced by the National Association of Insurance Commissioners and the prospects for achieving state-based regulatory reforms. Before we hear from our experts, I believe that it is important to review some observations about the insurance industry that I have raised at our previous hearings on these matters.

Insurance, as my colleagues already know, is a product that transfers risk from an individual or business to an insurance company. Every single American family has a need for some form of insurance, especially products like auto, renters and homeowners insurance. The vast majority of these families also has or wants other insurance products like life, health and long-term care policies.

The McCarran-Ferguson Act authorized the states to regulate the insurance business, and four years ago this month the Congress reaffirmed this system in approving the law to modernize the financial services industry. As a result, each state currently has its own set of statutes and rules governing the insurance marketplace. Traditionally, the states have highly regulated the insurance industry. Many states, however, have begun to experiment with their regulatory models in recent years.

In the last several sessions of Congress, our Committee has held regular hearings about the need for regulatory reform in the insurance industry. During these debates we have heard from a variety of viewpoints on the need for reform and the options for achieving it. These hearings have also helped to educate us generally about the mechanics of the insurance industry and the latest regulatory developments in it.

As a whole, however, the federal government continues to lag behind in its knowledge of insurance issues. As our witness from Mass Mutual will point out later today, the insurance business is the only portion of the financial services industry that does not have a regulatory presence in Washington.

At times, this lack of expertise has caused difficulties for us. For example, although many Members of Congress had concerns about the insurance industry's ability to respond to the 2001 terrorist attacks, they had difficulty in immediately identifying federal experts to advise them in these matters. The deficiency of federal knowledge about the insurance industry might have also impeded our efforts to adopt expeditiously the terrorism reinsurance backstop law.

Everyone involved in the debate on the future of insurance regulation agrees on the need for reform. From my perspective, promoting competition through fair and effective regulation should ultimately result in better and more affordable insurance products for consumers. While I

am pleased that the National Association of Insurance Commissioners recently released an action plan for pursuing further modernization efforts for regulating the insurance marketplace, this proposal was developed three-and-a-half years after the release of its paper calling for the efficient, market-regulation of the insurance business. Absent demonstrated advances in these state insurance regulatory efforts going forward, the Congress may need to consider altering these statutory arrangements through the creation of an optional federal chartering system or the adoption of other reforms.

In closing, Mr. Chairman, I want to commend you for bringing these matters to our attention. I believe it important that we learn more about the views of the parties testifying before us today and, if necessary, work to further refine and improve the legal structures governing our nation's insurance system. I yield back the balance of my time.

PRESIDENT: REP. KATHLEEN KEENAN, VT
VICE PRESIDENT: SEN. STEVEN GELLER, FL
SECRETARY: REP. CRAIG EILAND, TX
TREASURER: REP. FRANK WALD, ND

TESTIMONY OF NEW YORK STATE SENATOR NEIL BRESLIN

ON BEHALF OF THE

NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL)

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

HEARING ON

REFORMING INSURANCE REGULATION – MAKING THE MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

WASHINGTON, D.C.

NOVEMBER 5, 2003

EXECUTIVE COMMITTEE CHAIR: SEN. ALAN SANBORN, MI; **EXECUTIVE COMMITTEE:** REP. GLENN ANSARDI, LA; SEN. DAVID BATES, RI; DEL. J.D. BEANE, WV; REP. SHIRLEY BOWLER, LA; SEN. NEIL BRESLIN, NY; SEN. THOMAS BUFORD, KY; REP. LON BURNAM, TX; ASSEM. NANCY CALHOUN, NY; REP. MAUREEN DAKIN, VT; REP. ROBERT DAMRON, KY; REP. GREGORY DAVIDS, MN; SEN. BOB DEARING, MS; SEN. FRANK DEEM, WV; REP. ANTHONY DELUCA, PA; SEN. ROBERT DUNCAN, TX; REP. STEPHEN EHARDT, MI; REP. DAVID EVANS, OH; ASSEM. DONNA FERRARA, NY; REP. RICH GOLICK, GA; SEN. BILLY HEWES, MS; SEN. JAY HOTTINGER, OH; REP. GEORGE KEISER, ND; REP. BRIAN KENNEDY, RI; SEN. DEAN KIRBY, MS; SEN. JERRY KLEIN, ND; REP. RICHARD LAIRD, AL; SEN. DAVID LANDIS, NE; SEN. CAL LARSON, MN; REP. ALLEN LAYSON, AL; SEN. CARROLL LEAVELL, NM; REP. JIMMY LORD, GA; SEN. GLENN MCCONNELL, SC; REP. ANTHONY MELIO, PA; REP. MARY ANN MIDDAUGH, MI; REP. VIRGINIA MILKEY, VT; REP. PHIL MONTGOMERY, WI; SEN. ALAN NUNNELEE, MS; SEN. PAMELA REDFIELD, NE; SEN. BEN ROBINSON, OK; SEN. DALE SCHULTZ, WI; SEN. JAMES SEWARD, NY; REP. DAN WARD, MD; REP. MARK YOUNG, VT; **PAST PRESIDENTS AND MEMBERS OF THE EXECUTIVE COMMITTEE:** SEN. WILLIAM J. LARKIN, JR. NY; REP. TERRY PARKE, IL; ASSEM. CLARE FARRAGHER, NJ; SEN. HARVEY TALLACKSON, ND; REP. LEO FRASER, NH; **EXECUTIVE DIRECTOR:** ROBERT MACKIN; **DEPUTY EXECUTIVE DIRECTOR:** SUSAN NOLAN; **NATIONAL OFFICE:** 139 LANCASTER STREET, ALBANY, NY 12210-1903; TEL: 518-449-3210; FAX: 518-432-5651; **WASHINGTON OFFICE:** 601 PENNSYLVANIA AVENUE, NW, SUITE 900, SOUTH BUILDING, WASHINGTON, DC 20004; TEL: 202-220-3014 FAX: 202-220-3016; WEBSITE: WWW.NCOIL.ORG

Chairman Baker, Members of the Subcommittee, thank you for inviting the National Conference of Insurance Legislators (NCOIL) to testify before you today. I'm New York State Sen. Neil Breslin. It is my privilege to represent the 300,000 residents of the City and County of Albany in the New York Senate where I serve as Ranking Minority Member of the Senate Finance and Insurance Committees.

It is also my privilege to serve as Chairman of NCOIL's State-Federal Relations Committee.

NCOIL is a non-partisan organization of state legislators whose primary purpose is to develop and promote legislation that protects consumers and fosters a vibrant insurance industry.

Many legislators active in NCOIL either chair, or are members of, the committees responsible for insurance in their respective legislative houses in states across the country.

As I stated in testimony before Chairman Oxley and the members of the Commerce Committee in 2000, NCOIL welcomes the oversight of Congress on insurance regulation. We are grateful for the ongoing dialogue with this Committee on efforts to improve the state-based system of insurance regulation.

Since its inception more than 30 years ago, NCOIL has supported state regulation of the business of insurance as authorized by Congress in the McCarran-Ferguson Act.

The states have established a strong record under that authorization. Insurance markets have grown and become increasingly competitive in terms of price and products. There are more than 3,300 property and casualty insurance companies and over 1,800 life and health insurance companies now in competition for customers in U.S. insurance markets. The insurance industry is one of the most highly regulated industries in the U.S. No other industry subject to this degree of regulation offers such a competitive environment to American families and businesses.

At the outset, I would like commend the National Association of Insurance Commissioners (NAIC) for their work to improve insurance regulation. The recently adopted "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan" clearly demonstrates their understanding of the challenges facing insurance regulation in the 21st Century.

While such pronouncements are laudable, they demand follow-up with real, measurable results. And more important, such regulatory improvements need to happen without delay.

NCOIL has identified many of the same goals as priorities for regulatory modernization. We have and are developing model laws that would give regulators the

proper statutory authority to carry out needed reforms and, at the same time, would ensure a level of uniformity that will provide insurers with regulatory certainty.

Without such statutory underpinnings, interstate agreements or other administrative or regulatory reform initiatives will last only as long as those who signed them remain in office or until they change their minds.

State legislators are pleased with the NAIC's willingness to work together with us on regulatory modernization – particularly in the area of market conduct reform – to improve insurance regulation for the benefit of consumers and insurers alike.

In my testimony today, I will report to you on the progress NCOIL has made to improve regulation of the insurance marketplace, and our vision for continued modernization.

KEY AREAS OF REFORM

I am here to say that insurance regulatory modernization is well on its way.

By the end of this year, NCOIL will have adopted model laws, or passed resolutions in support of NAIC model laws, addressing four areas of insurance regulation requiring immediate improvement. I would like to take a moment to provide you with a brief overview of what NCOIL has done in each of those areas.

Insurance Producer Licensing

Reform of the multi-state licensing process for insurance producers had demanded immediate action. Under the previous system, it was not uncommon for an insurance agent or broker to wait for more than a year to get licensed in all jurisdictions. The delay was due in large part to idiosyncratic and outdated state-by-state requirements – requirements that did little, if anything, to protect the insurance buyers.

The states rose to the challenge and enacted insurance producer licensing reform legislation, albeit under the threat of a federal takeover of the multi-state licensing function as proposed in the National Association of Registered Agents and Brokers (NARAB) provision of the GLBA. These reciprocity laws now make it significantly easier for producers to receive state licenses.

Today, the NAIC has certified 41 states as meeting the requirements for producer licensing reciprocity under GLBA. I am happy to report that late last month New York enacted producer licensing legislation that meets GLBA requirements. We expect the NAIC to certify New York as the 42nd state.

"Speed-to-Market" for Insurance Products

Critics of state regulation point to the state-by-state regulatory approval process as too slow and too cumbersome, putting insurance carriers on an un-level playing field with

other financial service providers. They say it can take two years to win approval of a product in all 51 jurisdictions.

NCOIL has taken a two-pronged approach to improving the insurance product approval process.

First, for the approval of property-casualty products, NCOIL has adopted the *Property-Casualty Insurance Modernization Act*.

The model law would create a less cumbersome regulatory system and would rely on market competition, which many believe would result in lower insurance costs for consumers. In essence, the model relies on market forces to regulate rates while providing for consumer protection. It contains the essential features of an NCOIL commercial lines deregulation model law which more than 20 states have already adopted.

The NCOIL model is a step toward the competitive rating system found in Illinois. The NCOIL model offers states an alternative to prior approval mechanisms that can stifle innovation and force higher prices upon consumers.

To date, several states have based their insurance rate modernization initiatives on the concepts found in the NCOIL model law. NCOIL is scheduled to review that model law at its upcoming Annual Meeting to determine if it could be improved to gain broader acceptance in the states during the 2004 legislative sessions.

Second, for the approval process for life insurance and related products, NCOIL worked closely with the NAIC and NCSL on the development of its *Interstate Insurance Product Regulation Compact*. NCOIL has long endorsed the idea of interstate as way of making the state-based system of insurance regulation more uniform. It was my privilege to recommend the compact approach in testimony to a hearing of the Commerce Committee in 2000.

The *Interstate Insurance Product Regulation Compact* would develop uniform product standards and create a central clearinghouse to receive, review and approve products traditionally provided by life insurance companies.

It would bring greater uniformity, efficiency, and speed to the insurance product approval process.

NCOIL earlier this year adopted a resolution supporting the Compact and is encouraging the states to consider it during the 2004 legislative sessions.

Company Licensing

The process for companies to obtain a new license to do business in a state, or to re-domesticate to another state continues as a problem in search of a solution. In

response to that problem, NCOIL adopted in July of 2002 the *Company Licensing Modernization Model Act*. The model act can promote consistency among the 50 states in licensing insurance companies by using common licensing requirements, forms, and procedures found in the NAIC Uniform Certificate of Authority Application (UCAA).

The NAIC has made good progress streamlining and simplifying company licensure through its Accelerated Licensure Evaluation and Review Techniques (ALERT) program. However, state-specific deviations still remain. State enactment of the NCOIL company licensing model will bring greater uniformity to company licensing. NCOIL will be working with the states toward enactment of the model act in 2004.

Market Conduct Regulation

As NCOIL Past President Rep. Terry Parke (IL) testified in May of this year before the Oversight and Investigations Subcommittee, problems with the current market conduct regulatory system are glaring. Rep. Parke based his statement on a four-year examination of market conduct regulation by NCOIL and the Insurance Legislators Foundation (ILF), NCOIL's educational and research arm.

That examination produced two comprehensive reports entitled: *"Insurance Market Conduct Examination: Public Policy Review,"* released in 2000, and *"The Path to Reform -- The Evolution of Market Conduct Surveillance Regulation,"* released in May of this year.

The earlier study found, among other things, wide disagreement regarding the purpose of market conduct examinations, especially as to whether such examinations should focus on general business practices or only on specific violations of law. The same study found little coordination of market conduct examinations by states, leading to widespread and wasteful redundancies. The more recent study affirmed that the focus of market conduct regulation, particularly examinations, should be to prevent and remedy unfair practices that have a substantial adverse impact on consumers, not to identify inadvertent and minor violations.

The findings of the two NCOIL/ILF reports are consistent with state market conduct regulation problems found in the recent U.S. General Accounting Office (GAO) report entitled: *"Insurance Regulation – Common Standards and Improved Coordination Needed to Strengthen Market Regulation."* As you are aware, the GAO report recommended:

> "...that the NAIC and the states give increased priority to indemnifying and a common set of standards for a uniform market oversight program that includes all states. These standards should include procedures for conducting market analysis and coordinating market conduct examinations. Further, NAIC needs to establish a mechanism to encourage state legislatures and insurance departments to adopt and implement standards."

NCOIL recognized that the development of a model law was the best mechanism to address the market conduct regulation problem. In August of this year, NCOIL formed a Market Conduct Regulation Task Force charged with drafting such a model law. After its formation, the Task Force set an aggressive timetable for adoption of the model act.

I am happy to report that NCOIL will consider a *Market Conduct Surveillance Model Act* when it convenes its Annual Meeting later this month in Santa Fe, New Mexico. That model act would provide a statutory framework for market conduct regulation, and that would

- Create a regulatory continuum ranging from market analysis to full-blown market conduct examinations
- Provide for the possibility of domestic deference for market conduct regulation activities
- Establish uniform examination procedures
- Require coordination of states' market conduct activities through NAIC databases and initiatives
- Require a periodic dialogue between regulators and insurers regarding new statutory and regulatory requirements

Once the model law is adopted by NCOIL and enacted by the states, market conduct regulation will provide consumers with a greater level of protection than they have today. Market conduct regulation will no longer consist of a "dragnet approach" to uncover problems and violations. Rather, marketplace analysis and targeted examinations will ensure that industry practices that cause the greatest harm to consumers will be identified and corrected.

The new market conduct regime would place the onus for compliance in large part on individual insurers. Regulators would expect a "culture of compliance" to emerge within insurance companies. Regulators' resources and expertise would be used more efficiently through interstate collaboration and coordination.

CONCLUSION

It is no coincidence that over the past three years NCOIL has re-doubled its efforts to bring about real and measurable improvements to insurance regulation. State legislators are acutely aware of the forces at work to create an optional federal charter for insurance companies. Our heads are not in the sand. We understand that political and marketplace realities demand that we improve state regulation. We understand that the status quo is not an option.

In previous testimony before this Subcommittee, NCOIL articulated its unwavering opposition to any encroachment on state insurance regulation. Our position has not changed. While not perfect, the state system of insurance regulation has worked, and worked exceedingly well for 130 years. NCOIL strongly believes the creation of a new federal bureaucracy would be unwise, and most likely harmful to insurance buyers.

State legislators know that more work needs to be done, and we will get it done. State legislators and state regulators are working together to create uniformity in the key areas of insurance regulation.

NCOIL welcomes the attention that you, Chairman Oxley, and other members have given to the issue of insurance regulation. There is no question that your focus has expedited the pace of reform. I would be a happy to answer your questions.

Statement of the
Massachusetts Mutual Life Insurance Company

before the

Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
of the
House Financial Services Committee

On

Reforming Insurance Regulation –
Making the Marketplace Competitive for Consumers

November 5, 2003

Statement Delivered By:
William B. Fisher
Vice President and Associate General Counsel

Mr. Chairman and Members of the Subcommittee,

I am William B. Fisher, Vice President and Associate General Counsel, for Massachusetts Mutual Life Insurance Company ("MassMutual") based in Springfield, Massachusetts. MassMutual was founded in 1851 and conducts business in all 50 states, the District of Columbia and Puerto Rico. We are one of the largest life insurers in the United States and are one of only a handful of companies in our industry holding the highest possible financial strength ratings from Standard & Poor's, Fitch Ratings and A.M. Best. MassMutual is the parent company of a global, diversified financial services organization that operates under the name, MassMutual Financial Group. The member companies of the of the MassMutual Financial Group, which include Oppenheimer Funds, Inc., serve more than 10 million clients, have over $240 billion in assets under management as of December 31, 2002, and offer a broad-based portfolio of financial products and services including life insurance, annuities, disability income insurance, long term care insurance, retirement planning products, structured settlement annuities, mutual funds, money management and trust services.

I appreciate this opportunity to appear before you today on the subject of regulatory modernization for the insurance industry. We applaud the Chairman's and Subcommittee's continuing interest in modernization of insurance regulation, since it is one of the most critical issues facing both MassMutual and the entire insurance industry.

My testimony will cover the challenges facing an insurer within the current regulatory structure, our view of the status of current modernization efforts, and our support for enactment of optional Federal insurance charter legislation. At the outset, I note that my testimony is provided from the perspective of a life insurer that offers life insurance, annuities, disability income insurance and long term insurance. MassMutual does not issue property and casualty insurance. Many of the concerns with the current state of insurance regulation are common for all segments of the insurance industry. In some respects, however, there are differences in the concerns of life insurers and property and casualty insurers due to differences in their respective product lines and associated regulatory requirements. My remarks will be limited to the life industry issues.

Current Environmental Challenges.

The need for modernization of insurance regulation is well established and acknowledged in virtually all quarters. Over the past few years, this Subcommittee has held a series of hearings on various aspects of insurance regulation, including the inefficiencies and lack of uniformity in product regulation, producer licensing, and market conduct regulation. From MassMutual's perspective, these are the areas of regulation most in need of reform. However, I should also note that the underlying lack of uniformity and efficiency is systemic and permeates virtually all aspects of insurance regulation, albeit in many cases to a lesser extent.

The regulatory community, as represented by the National Association of Insurance Commissioners ("NAIC"), readily acknowledges the need for modernization and efficiency of state insurance regulation. In March of 2000 the NAIC released its *Statement of Intent* affirming its commitment to the goal of protecting insurance consumers as well as the need for efficient, market-oriented regulation of the business of insurance. More recently, in September of this year

the NAIC adopted its *Reinforced Commitment: Insurance Regulatory Modern Action Plan* which sets forth its blueprint and timing for implementation of regulatory modernization.

For a life insurer, such as MassMutual, that markets national products on a nationwide basis, the lack of a comprehensive, uniform and efficient regulatory system is more than a matter of frustration. Simply put, it translates into both a disservice to our customers and a competitive disadvantage for the company.

Our customers ultimately bear the cost of our having to comply with the duplicative and often conflicting state requirements. In addition, our inability to bring new products to market in a timely manner means that our customers do not have access to these products as rapidly as they should. New products typically incorporate the new features that benefit consumers. They also typically cost less than predecessor products, as is illustrated by the steady industry wide decline in the cost of life insurance over a long period of years.

Increasingly, life insurers compete with non-insurance financial institutions, such as banks and mutual funds. At one time life insurers competed only with each other, and the burden of any regulatory inefficiencies was borne by all. The environment has changed dramatically in recent years. Financial services integration and modernization is occurring throughout the insurance and financial services sector. For life insurance, consumers have a choice of buying a cash value product from a life insurer or buying term life insurance and investing the difference with a non-insurance competitor. More importantly, the product mix offered by life insurers has changed. Retirement security products and variable contracts have become an increasingly significant element of life insurers' product offerings in order to meet the needs of the marketplace. Industry statistics developed by the American Council of Life Insurers illustrate this point. A generation ago, the average life insurer took in almost 90 percent of its premiums from the sale of life insurance, compared to only 13 percent from annuities. Today, those numbers are almost completely reversed, with 70 percent of premium receipts coming from annuities compared to only 30 percent from life insurance products. Today, life insurers administer over $1.8 trillion in retirement plan assets, amounting to over 25 percent of the private retirement plan assets under management in the United States.

Our non-insurance competitors are subject to regulatory systems that are far more efficient than our current fifty-state insurance regulatory structure. The resulting competitive disadvantage for life insurers is amply demonstrated in a number of ways. Our greatest concern is with the current system of product regulation. Our competitors in other segments of the financial services industry are able to introduce new products nationally in a very short time frame and typically are able to obtain any requisite regulatory approvals from a single regulator. In contrast, a life insurer's products generally are subject to state-by-state prior approval in all jurisdictions in which the insurer does business. This is a very time-consuming process that, in the case of MassMutual, can take anywhere from one to one and a half years to complete, depending upon the product involved. In addition, the product approval process also involves application of differing state laws and, even when the laws are uniform, widely divergent state standards, interpretations and requirements are often applied to identical products.

The result is lost opportunities and unnecessary dedication of resources, and MassMutual's experience demonstrates this point. In June of 2001 I had the opportunity to testify before this Subcommittee on the need for modernization of the product approval system. At that time I stated that MassMutual estimated a loss of at least $80 million in sales (measured by premium) during the prior year due to inability to bring products to market on a timely basis. We recently updated this estimate. For 2002 alone we estimate that we lost up to $60 million in sales (measured by premium) due to the inability to bring our products to market within 60 days of filing with our regulators. While the updated estimate reflects some improvement, it also demonstrates the continued need for regulatory reform. The lack of uniformity in product regulation is also a serious problem. On a product-by-product basis, it is common for us to have anywhere from 30 to 40 versions of a single product due to variations in state laws and requirements. For one product, we have 48 versions. Imagine the issues this Subcommittee would be dealing with if mutual funds, securities and bank products were required by state laws to be customized on a state-by-state basis.

The current inefficiencies are not limited to product approvals. A national life insurer is subject to the market conduct requirements of every state in which it does business. Although in many respects the market conduct laws of the states are similar, substantial differences exist among the states in other areas, such as mandated disclosures, replacement requirements, complaint notices, and interest on death proceeds requirements. In addition, the process for conducting market conduct examinations has not been coordinated among the states and has resulted in duplicative examinations, the associated unnecessary expense, and sometimes substantially differing findings. By way of example, in the past five years, MassMutual has undergone 14 separate state market conduct examinations. The average duration of these examinations from initiation to issuance of the final report generally ranges from six to twelve months, and the examinations often involve on-site reviews lasting 90 days.

The Gramm-Leach-Bliley Act of 1999 ("GLBA") provided for federal control of producer licensing if fewer than 29 states adopted a uniform or reciprocal producer licensing system by November 2002. While the states surpassed this number with ease and 50 jurisdictions have adopted laws designed to satisfy the requirements of GLBA, the result has been a reciprocal licensing system as opposed to a uniform licensing system. While today's producer licensing system is more efficient than that which existed in 1999, insurers such as MassMutual continue to devote resources to comply with licensing requirements that unnecessarily vary among the states. For example, several states maintain appointment, continuing education, fingerprint, and bonding requirements that differ from others. With regard to producer appointments, before a licensed producer may market the products of a particular insurer, the insurer must first process an "appointment" with the insurance department of each state in which a producer is licensed and will market its products. The effective date of these appointments still varies widely among the states. Some states require an insurer to submit an appointment request and wait for a response that will inform the insurer of the effective date of a particular appointment; other states make the appointment effective on the date it is submitted electronically; still other states permit insurers to pick the date the appointment will be effective. While these variations have been the subject of much debate at the NAIC and efforts continue to resolve them, the result of reciprocity rather than uniformity has resulted in the need for insurers to maintain costly systems and experience needless delays to respond to state specific requirements. In short, while the threat of

federal control prompted marked improvement in producer licensing from an insurer perspective, the improvement falls short of the uniformity that is required to achieve regulatory efficiency.

Current Modernization Efforts.

Since the NAIC's original *Statement of Intent* in March of 2000, state insurance regulators have dedicated extensive commitment and resources to reforming state insurance regulation. The NAIC's recently released *Reinforced Commitment: Insurance Regulatory Modernization Action Plan* outlines the actions taken thus far for the system as a whole. In addition, some states have worked diligently to initiate reforms within their respective jurisdictions, such as creation of product filing and approval checklists.

While most of the activity thus far has been in the state insurance regulatory community, there has also been activity in state legislatures. Since the passage of the NARAB provisions of GLBA, 50 jurisdictions (including one major state in the past few weeks) have passed the NAIC's Producer Licensing Model Act. As currently implemented, this Act provides for reciprocity among states relative to non-resident producer licensing. At the national level NCOIL is working on development of its Market Conduct Surveillance Model Law that would establish a market conduct analysis and examination legislative framework to provide greater efficiency in market conduct regulation and examination processes. The NAIC is an active participant in the NCOIL process. Finally, the NAIC has adopted Interstate Insurance Product Regulation Compact model legislation that has been endorsed by both the NCSL and NCOIL.

MassMutual has supported and will continue to support all of these efforts toward modernization of insurance regulation. Our support is more than just words, since we have actively participated in a number of these efforts. For example, I personally have been a lead industry voice working with the NAIC and NCSL on development of the Interstate Compact legislation. More recently I and others at MassMutual have been actively involved in the NAIC's development of sample product standards for the Interstate Compact. The NAIC is developing these standards largely for the purpose of showing legislatures considering passage of the Interstate Compact what the product standards might look like. In all likelihood, the product standards developed by the NAIC will serve as the basis for the final standards adopted by the Interstate Compact Commission when the Compact becomes operational.

MassMutual has no doubt about the good faith and commitment of the states toward modernization of insurance regulation. Given the basic nature of a fifty-state regulatory system and the accompanying political and other challenges, however, we are concerned about the ability of the states to achieve the comprehensive uniformity and regulatory efficiency that is sorely needed. Our reasons are several fold.

First, within a fifty-state regulatory system the primary responsibility of each state insurance regulator is to protect the residents of that state. To the extent that consistent application of uniform laws and standards is recognized by state officials as fulfilling this responsibility, the current system of regulation would achieve uniform and efficient regulation. As a practical matter, however, there have been and undoubtedly will continue to be differences in policy,

opinion and processes among the states on how best to protect consumers. These continuing differences defeat the efforts to achieve the goal of true regulatory modernization.

A recent development illustrates this point. Several years ago the NAIC developed an electronic filing system for insurance products known as System for Electronic Rate and Form Filing (SERFF). SERFF offers a one-stop, single point of electronic filing and is becoming increasingly available to and utilized by insurance companies. The NAIC's recently released *Reinforced Commitment: Insurance Regulatory Modernization Action Plan* establishes the goal of insurance departments to be able to receive product filings through SERFF for all major lines and product types by December of 2003. Notwithstanding the common acceptance of SERFF by both regulators and industry, in July of this year one major state adopted a regulation requiring all filings to be submitted through a totally different electronic filing system.

Second, regulatory efficiency in a 50 state system assumes a very high level of cooperation and interdependence among regulators. Assuming uniformity of the underlying laws and regulatory requirements to be enforced, achieving this cooperation and interdependence is conceptually possible. The fifty state regulatory system, however, almost necessarily involves differing legal requirements, which seemingly will inhibit the ability of regulators to achieve the necessary cooperation and interdependence.

An illustration of this concern is the NAIC's action plan for regulatory modernization, the *Reinforced Commitment*, which relies heavily upon deference by insurance regulators to the home state regulator. For example, insurance producers would be required to satisfy only their home state pre-licensing education and continuing education requirements. Similarly, in the market regulation arena reliance is placed upon the home state regulator of a "nationally significant" company to produce a market regulatory profile for that company and to conduct market conduct examinations of those companies. Non-home state regulators would not be permitted to conduct a market conduct examination in the absence of a specific reason that requires a targeted market conduct examination by that state. Whether the requisite level of deference will be achieved remains to be seen, since the *Action Plan* does not envision changes to the substantive market conduct standards that vary from state-to-state in areas such as advertising, disclosures, and replacement requirements. The varying state requirements place an inherent limitation on the ability of one state to rely upon another state's market conduct examinations, and state regulators cannot delegate to another state the responsibility of enforcing their own state's laws.

Finally, uniformity within a fifty state system will require more than action by regulators. In many cases, such as product regulation, legislation will be required to eliminate the more problematic differences in state requirements. The need for legislation introduces another level of complexity, both substantive and political.

The NAIC affirmed the need to improve regulatory efficiency in March of 2000. Today, more than three years later, the NAIC, again to its credit, is recommitting itself to the goal of regulatory efficiency, but this time with an explicit goal of year-end 2008--more than five years from now and the goal is partial uniformity. Aside from concerns about the extent of progress achieved to date, the extended period of time of five years to achieve partial uniformity is of

concern. Business activity often moves at a faster pace than does regulatory or legislative activity. That said, we need to state plainly--full uniformity is needed today.

Product Regulation – A Case Study.

The current status of life insurance product regulation reform efforts provides a good case study of our concerns about the prospect for complete success in modernizing state regulation.

When I testified before this Subcommittee in June of 2001 on the need for modernization of the insurance product approval system, the NAIC had just launched a pilot project involving ten states known as the "Coordinated Advertising, Rate and Form Review Authority" ("CARFRA"). CARFRA was designed to provide insurers with a single point of product filing. Although products filed with CARFRA would be reviewed using newly developed national product standards, participating states had the ability to retain their own state-specific product requirements. Unfortunately CARFRA has not been a success, primarily because it did not address the underlying problem of a lack of uniform state laws. By its nature, CARFRA must operate within the constraints of the existing legal structure, where deviations in product content exist state-by-state.

In order to address the uniformity problem, in March of 2002 the NAIC initiated work on developing its Interstate Insurance Product Regulation Compact model legislation. That effort was completed in July of 2003 with the NAIC's adoption of the Interstate Compact model. The Interstate Compact has also been endorsed by the National Conference of Insurance Legislators and the National Conference of State Legislatures.

The Interstate Compact would provide a single point of filing and approval for life insurance, annuities, disability income insurance and long term care insurance. Approval of a product filing by the Compact Commission would enable an insurer to issue the approved product in all states which participate in the Interstate Compact.

The Interstate Compact addresses the lack of uniformity problem by authorizing the Compact Commission to establish product standards for filings made with the Compact. These standards would be established through a regulatory process provided for in the Interstate Compact legislation. A participating state may opt out of a Compact product standard by legislation or by regulation. In the case of an opt out by regulation, the state Insurance Commissioner must make certain specific findings of fact and conclusions of law and determine that the Compact product standard does not reasonably protect the citizens of that state. In the absence of an opt out, the Compact product standard is binding upon each participating state and, subject to certain exceptions supersedes the individual state law applicable to the content and approval of the product covered by the Compact standard.

By its terms the Interstate Compact becomes operational only after 26 states, or states representing 40% of the national business as measured by premium volume, become participating states. Passage of the Interstate Compact legislation in a state will be required before that state can participate in the Compact.

MassMutual supports the Interstate Compact, but also sees a very uncertain prognosis for its success in the future. At the NAIC there has been broad-based support for the Interstate Compact by most, but not all, state insurance regulators. At this point, the depth of this support is not entirely clear in terms of the commitment of each state insurance regulator actively to seek passage of the Interstate Compact in the legislature of the applicable state. The level of regulator support may depend in part upon the nature of the product standards to be developed for the Interstate Compact. As noted previously, the NAIC is currently working diligently to develop sample national product standards in connection with the Interstate Compact. Several large states, however, reportedly are engaging in an effort separate from the NAIC to develop product standards for the Interstate Compact.

Even assuming full regulatory support for the Interstate Compact, its passage by each state legislature is not clear. Passage of the Interstate Compact constitutes a significant delegation of regulatory authority to a multi-state entity, and there will undoubtedly be political opposition on a state-by-state basis to passage of the Interstate Compact.

The NAIC's *Reinforced Commitment* seemingly recognizes these obstacles to making the Interstate Compact a success. The stated intent in that document is to have the Compact operational in at least thirty states or states representing 60% of the national premium volume for the products involved by year-end 2008. Even if this goal is achieved, it would all far short of achieving comprehensive, uniform and efficient product regulation.

Optional Federal Charter Is Needed.

Although the product regulation, market conduct and producer licensing issues are of the greatest concern to MassMutual, the need for regulatory modernization is more extensive. Insurance regulation covers a broad array of other issues, such as insurer solvency (e.g. reserves, risk based capital, valuation actuary opinions, accounting standards, investment requirements), company licensing, holding company requirements (e.g. registration statement filings, material transactions among affiliates, oversight of mergers and acquisitions), oversight of changes in corporate form (e.g. demutualization), redomestication laws, and underwriting and insurable interest requirements. Depending upon the area of regulation involved, the state requirements range from almost total uniformity to greatly differing standards. These areas should not be left out of any regulatory modernization solutions.

As noted above, MassMutual remains committed to working with the NAIC and the states to achieve regulatory modernization, but we harbor doubts about the ability of the state system to achieve fully the necessary modernization. Even assuming comprehensive modernization is achievable at the state level, all indications are that successful completion of this effort will be an extended process. Simply put, a life insurer such as MassMutual that is facing increased competitive pressures does not have the luxury of waiting to see how successful the state modernization efforts will be.

For those reasons, we support Congressional enactment of Optional Federal Charter legislation for insurers. The Optional Federal Charter concept also enjoys broad support across the entire life insurer industry. The system we envision is similar to the banking regulatory structure under

which banks have the option of being chartered at either the Federal or state level. The key attributes of the Optional Federal Charter system that we envision are as follows:

Consumer Protection. The purpose of any insurance regulatory system is to provide strong protection for the consumer, and there is no doubt that consumer protection can be fully achieved under an Optional Federal Charter. A Federally chartered insurer would be subject to the jurisdiction of a strong Federal insurance regulator.

MassMutual supports enactment of an Optional Federal Charter law that incorporates the same strong level of legislative and regulatory standards as are currently found in state insurance regulation. These standards include strict requirements for insurer licensing; insurer solvency; market conduct including sales and marketing practices; oversight of corporate transactions including mergers and acquisitions; and product administration including claim administration and complaint handling. We support legislation that continues product regulation for life insurance, annuities, disability income insurance and long term care insurance, utilizing substantive standards of the same strictness as are found in the states today.

Uniformity and Efficiency. Since an Optional Federal Charter provides a single point of insurance regulation for federally chartered insurers, by definition it provides a comprehensive system of uniform national regulation for products, agent licensing, market conduct and other regulatory activities and requirements associated with a Federally chartered insurer. No other solution could provide the same level of comprehensive uniformity, particularly if only certain areas of regulation are targeted for modernization. In terms of efficiency, the single regulator system embodied in Optional Federal Charter also offers the best solution for avoiding duplicative requirements and duplicative efforts.

Washington Presence. The life insurance industry is an important element of the Nation's economy. According to industry statistics, fifty-seven percent of the industry's assets -- $2 trillion -- is held in long-term bonds, mortgages, real estate and other long-term investments. The industry ranks fourth among institutional sources of funds, supplying 9% of the total capital and financial markets, or $3.4 trillion. Investments include: $417 billion in Federal, state and local government bonds, $251 billion in mortgage loans; $1.2 trillion in long-term U.S. corporate bonds; and $791 billion in corporate stocks. In 2002, life insurers invested more than $304 billion in new net funds in the Nation's economy.

Notwithstanding this economic presence, the insurance industry is the only segment of the financial services industry that does not have a regulatory presence in Washington. The importance of a Washington presence on insurance issues cannot be underestimated. A Federal insurance regulator will serve as an important and expert resource on insurance issues for Congress and the Administration at both the national and international levels. The need for such a presence is becoming increasingly evident as the Federal Government becomes more involved with the insurance industry. Last year Congress enacted the Terrorism Risk Insurance Act of 2002. The Patriot Act applies to insurers, and the Treasury Department is in the process of adopting implementing regulations for

> the insurance and is exploring with state insurance regulators the possibility of having those state regulators examine insurers for compliance with the Patriot Act. In addition, Title V of the Gramm-Leach-Bliley Act calls for privacy regulation of the financial services industry by the functional regulators. In the case of insurance the functional regulators are the state insurance regulators, and the result is a relatively inefficient, multi-state implementation of the Federal privacy requirements. Any changes to the notice or other privacy requirements under Gramm-Leach-Bliley would require action by the states.

Opponents of an Optional Federal Charter for insurance companies have raised a number of concerns. For the reasons set forth below, we do not agree that those concerns have merit.

State Tax Revenues Will Not Be Lost. Currently life insurance companies pay taxes to the states in the form of a tax on premiums received. A primary argument of Optional Federal Charter opponents is that enactment of Federal charter legislation will result in elimination of Federally chartered insurers' obligation to pay these taxes either at the outset or at least after some period of time. This concern is unfounded for several reasons.

First, MassMutual and the entire life insurance industry support the continuing imposition of these taxes on Federally chartered insurers to the same extent that they are levied upon state chartered insurers. This position is evident in the industry draft Optional Federal Charter proposals that MassMutual has seen, which expressly provide for the continued obligation of Federally chartered insurers to pay these taxes.

Second, elimination of this tax obligation would require an Act of Congress, and we cannot conceive of Congress taking such action. One apparent underlying theory for such action is that Congress would be motivated to repeal the provisions subjecting Federally chartered insurers to state premium tax obligations in order to divert those tax revenues to Federal Government coffers. Given the longstanding precedent of having other federally chartered institutions, such banks and thrifts, pay state taxes, it makes no sense that Congress would treat the insurance industry any differently.

Regulatory Arbitrage Will Not Result. Some fear that Optional Federal Charter will lead to a regulatory "race to the bottom". Under this theory, regulators will compete to have the least stringent regulation, in order to woo insurers to their regulatory system. Through the ability to change charters at will, insurers will naturally migrate to whatever jurisdiction has the most relaxed regulation at the time.

This argument is premised on several erroneous concepts. One is that enactment of a Federal Charter option will somehow create a new and far less stringent regulatory system than is currently found in the states. This makes no sense, because the industry is seeking a strong Federal regulatory system that is equivalent to the current system of state insurance regulation. We do not see any rationale or motivation for Congress to act otherwise or to permit the Federal insurance regulator to adopt loose regulatory standards. Finally, there is a fatal flaw in the underlying assumption changing a charter from state to Federal or vice versa is a simple and easy transaction. The reality is that a change in an organization's basic governance and regulatory

oversight is a major corporate transaction that cannot be taken lightly in view of the business disruption, cost and requisite dedication of corporate resources that would necessarily be involved.

States' Rights Are Preserved. The argument that an Optional Federal Charter is a direct assault on states' rights is wrong for several reasons. First, under the structure we propose a Federal charter is an option, not a mandate. While it is true that some insurers will opt for a Federal charter, it is equally true that many insurers will elect to remain state chartered. Certainly this has been the longstanding experience in the bank regulatory system. Thus, Optional Federal Charter preserves state insurance regulation. Unlike S. 1373 introduced by Senator Hollings, Optional Federal Charter does not represent a Federal takeover of regulation of interstate insurance. Nor does it infringe on states' rights as would be the case with Federally mandated minimum standards.

Second, seeking comprehensive, uniform and efficient insurance regulation, as well as a Washington presence on insurance issues, should not be viewed as an assault on states' rights. Rather, a Federal insurance regulatory structure and the state insurance regulatory system complement each other. One of the longstanding arguments for state regulation is that the states serve as laboratories for innovation. Necessarily, this argument assumes that there should and will be diversity in standards and laws from state to state. A Federal regulator also serves as a laboratory, but in a different way. Through a Federal regulator is achieved the value of applying uniform national standards to insurers that have national products and markets.

Conclusion.

The need for comprehensive, uniform and efficient regulation of insurance is pressing in view of the competitive pressures faced by the life insurance industry, the current inefficient regulatory structure, and the attendant resulting costs that are ultimately borne by consumers. State regulators have demonstrated a tremendous commitment to modernizing the state system of insurance regulation, but serious obstacles stand in the way of their efforts.

An Optional Federal Charter for insurers represents the best way of achieving comprehensive, uniform and efficient insurance regulation. In order to protect consumers, such a system must include insurance regulation that is as strong as the regulation currently found in the states.

Mr. Chairman and members of the Subcommittee, I thank you for this opportunity to make our views known to you on this critical issue.

Testimony of
Progressive Casualty Insurance Company

Before the
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises

Committee on Financial Services in the United States House
of
Representatives

Reforming Insurance Regulation - Making the Marketplace
More Competitive for Consumers

November 5, 2003

Good afternoon Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is John Fitts, Deputy General Counsel of Progressive Casualty Insurance Company and I am pleased to have the opportunity to provide Progressive's viewpoint on insurance regulation and its impact on competition at today's hearing.

Progressive Casualty Insurance Company and its affiliated and subsidiary companies comprise collectively the third largest private passenger automobile insurer in the nation (Progressive) and the largest writer of auto insurance through independent agents. Progressive offers competitive rates for all risks and provides claim and policyholder services 24 hours a day, 365 days a year. We market insurance by phone, through more than 40,000 independent insurance agencies, and were the first to sell auto insurance over the Internet.

Progressive was also the first company to offer immediate response claims service, provide comparison rates from competitors and experiment with pricing insurance based upon when and where a person drives. With more than nine million customers, Progressive is committed to using the latest technology and innovation to reduce costs and improve customer experience. More information about Progressive can be found at progressive.com.

There is common acceptance by all stakeholders that the current insurance regulatory system needs to be reformed. Beyond that, opinions diverge with respect to the best way to approach this task. While many insurers are absolutely committed to state regulation of insurance, others have already concluded or are coming to the conclusion that some type of federal involvement is necessary to achieve regulatory modernization.

Progressive agrees that insurance regulatory reform is necessary and in the best interest of all stakeholders. We believe that the best regulatory model:

- Encourages competition, availability, and innovation in product design;
- Eliminates multiple layers of regulation;
- Facilitates the use of pricing and underwriting practices as long as they are fair and actuarially supported;
- Provides speed to market so that forms and rates for new and existing products can be used within reasonable time frames;
- Preserves the existing post-assessment solvency funds system and its fiscal stability;
- Provide expeditious company and producer licensing processes with consistency, uniformity, and flexibility;
- Permits companies to enter and leave markets without undue interference, cost or delays;
- Identifies and eliminates outdated regulatory requirements that no longer serve valid regulatory objectives;
- Provides flexibility that allows insurers to innovate and compete effectively against new rivals in the rapidly converging financial services industry;
- Eliminates regulatory variance in areas where there is no compelling need for difference;
- Is administered by regulators who are professional, knowledgeable about the industry, and capable of effectively balancing the interests of consumers and insurers; and
- Provides regulation that is consistent, sensible, reliable, and in accordance with law.

A regulatory system with these attributes will foster competition and make reasonably and accurately priced insurance available to more consumers. It will also encourage capital investment and promote a healthy insurance market. This can only benefit consumers.

In this statement, Progressive will discuss the impact of the current regulatory system on its business operations, provide its views on the ability of the state regulatory system to bring about meaningful reform, comment on the various federal solutions under consideration, and provide its current thinking on the best way to accomplish regulatory reform.

Impact on Progressive

Probably more than most industries, insurance is a pass through business. The costs Progressive incurs to provide its product (indemnification for covered losses) comprise the overwhelming majority of each dollar of premium written. These costs include claims payments and loss adjustment expenses, policy acquisition costs, and general administrative expenses, including costs associated with regulatory compliance. Since lower prices make Progressive more competitive, we work hard to manage costs in every aspect of our business.

As a national group of insurance companies, Progressive is subject to regulations in all 48 states where it does business. Progressive spends tens of thousands of man-hours and millions of dollars annually on compliance related activities and is keenly aware of the tremendous costs associated with developing the infrastructure, systems, and procedures necessary to assure compliance with the mosaic of state insurance regulations applicable to national insurance providers.

A significant percentage of our compliance costs are necessitated by the need to address the differences in rules that apply from state to state. Every difference between states requires a distinct compliance response. When these responses are applied to the totality of insurance regulation across 48 states and, at times, multiple product lines, the appeal of, and need for, uniformity become compelling. Simply stated, uniformity enhances efficiency and reduces cost. While some variance is necessary to respond to local conditions, there are many areas where there is no compelling need for regulation to vary by state.

Progressive is also subject to the various state rules with respect to rate and form approval. These laws vary both in form and application. While the approval process operates efficiently in some states, in others unreasonable delays impact our ability to charge adequate rates or offer new or revised policy forms. In some states the approval process is highly politicized. At times this can lead to unreasonable rate suppression that in turn can ultimately result in availability problems. Getting accurately priced products to the market on a timely basis is vitally important to consumers, regulators, and Progressive, but is not always possible under the rate and form approval process in place in some states.

Progressive is also subject to having its market conduct and finances examined regularly by the various states where it does business. A recent GAO study has documented a number of shortcomings in the current market conduct examination process. Some reduce the consumer protection value of market conduct exams while others result in an inefficient and redundant process. Neither outcome is in the best interest of Progressive or our customers.

Ironically, Progressive believes that the current system provides it with a competitive advantage. At many levels, the cost of compliance is the same whether an insurer writes 100 or 100,000 policies in a given state. While large groups of companies like Progressive can spread those costs over a broad customer base, smaller companies, or companies seeking to enter a new market do not have the same economies of scale and some have a difficult time building the infrastructure necessary to ensure compliance on a multi-state basis.

Nevertheless, the costs associated with insurance regulation exceed what is necessary to protect the interests of consumers properly and addressing this problem is clearly in the best interest of Progressive and its customers. Therefore, Progressive wholeheartedly supports reforms that will reduce the cost of regulatory compliance for all insurers and provide better speed to market without sacrificing consumer protection.

State Regulation

The state regulatory system generally performs a number of useful functions very well. It is responsive to local market conditions and plays an important role ensuring that consumers receive the coverage they need from solvent insurers that settle covered claims on a timely basis for fair and reasonable amounts. When disputes arise between insurers and their policyholders state insurance departments often effectively intervene to resolve them.

There are, however, inconsistencies in the nature and quality of regulation on a state-to-state basis and, to the extent that regulatory modernization embodies notions of uniformity and consistency, these objectives have proven to be very difficult to achieve in the current state based system. Despite the commitment to regulatory modernization by the NAIC leadership and many other regulators, the implementation of this agenda requires the commitment of each state insurance department and state legislature. With so many interested parties, achieving regulatory modernization is inherently cumbersome. It is extraordinary difficult, if not impossible, to pass identical laws and implement uniform regulatory policy and procedures in every state.

The recent experiences with the NAIC Model Producer Licensing Act (MPLA) and the state response to regulating insurance credit scoring are two examples of the difficulties associated with obtaining uniform regulation within the existing state system. Although most states have passed producer licensing laws that have been deemed MPLA compliant by the NAIC, there are still numerous differences in the state requirements for licensure including the application forms, background checks and finger print requirements, and rules associated with non resident licensing to name a few. Moreover, archaic paper intensive procedures still abound. In the final analysis, despite the intent behind the MPLA, Progressive has not been able to achieve meaningful reductions in its administrative costs relating to producer licensing compliance nor has it realized the efficiencies it had hoped to achieve in the operation of its direct call centers.

Over the last few years, many states have promulgated regulations, issued bulletins or passed laws regulating the use of credit information in rating and underwriting. The result has been a patchwork of differing regulation on issues such as the definition of adverse action, disclosure requirements, adverse action notice requirements, the types of credit information that can be used, the treatment of no hits and thin files, the treatment of renewals etc. Even with the NCOIL model act available as a national standard, few states adopted that model act without some modification and many states opted for a state specific bill.

During the last several years the NAIC has devoted substantial time and effort to the issue of regulatory modernization. To that end, the NAIC recently issued a document entitled "*A Reinforced Commitment: Insurance Regulatory Modernization Plan.*" This document does a good job of identifying those areas where regulatory reform is necessary, provides principles and goals that are consistent with meaningful reform, and provides action plans to achieve them. While we are concerned about the apparent lack of commitment to address speed to market issues in personal lines and feel that some of the time deadlines are too long, if the NAIC were able to implement the reforms discussed in the Reinforced Commitment document, it would be a tremendous accomplishment.

Progressive is, however, skeptical that the stated objectives of the NAIC can be accomplished under the current system where, once the deliberations at the NAIC have ended, each state is free to ignore the NAIC's recommendations or pursue a different regulatory policy. We believe that ultimately the NAIC would be more likely to succeed in its reinforced commitment if it had active federal support.

Progressive's views on the ability of the state regulatory system to reform itself should not be interpreted as an indictment of state regulation. We support state regulation and have tremendous respect for the regulators we work with on a daily basis. The Progressive Corporation and its largest subsidiary, Progressive Casualty Insurance Company, are fortunate to be domiciled in the State of Ohio. Director Ann Womer Benjamin and her predecessors have assembled a highly competent and professional staff who fairly balance the interests of consumers and insurers when discharging the regulatory powers of the Ohio Department of Insurance

In addition, we do not question the personal commitment of Commissioner Pickens and the leadership of the NAIC. The problem with the implementation of meaningful reform is systemic-- primarily relying on 50 state legislators to act uniformly-- and, in our judgment, cannot be effectively addressed under the current state system.

Federal Options

Progressive is not, however, a current proponent of an optional federal charter nor the federalization of insurance regulation. Creating a separate insurance regulatory system or dismantling the state system in favor of a federal system would be expensive, disruptive, and seemingly unnecessary to achieve the goals of regulatory modernization.

On first impression, the concept of a federal charter with companies subject to one national regulator might seem appealing. However, this appeal may be deceptively simple. In the private passenger automobile market, there are significant geographical variances in the law and coverages required. This creates a complexity that would make it extremely difficult for a national regulator to understand local market conditions and successfully respond to insurer or consumer concerns. In a dual regulatory system, there would undoubtedly be consumer confusion that would be exacerbated for consumers insured by both state and federally chartered companies. Moreover, the tension between state and federal regulation could ultimately lead to an unlevel competitive playing field. Lastly, bad regulatory policy would potentially have disastrous implications when applied on a national basis.

The recently introduced Insurance Consumer Protection Act (S1373) proposes to repeal the McCarran-Ferguson Act and create a "Federal Insurance Commission" housed within the Department of Commerce which would act as the sole regulator of all interstate insurers offering property and casualty and life insurance. The Commission would have authority over rate and forms, and be responsible for licensing, examination, solvency, market conduct, and accounting standards.

This sweeping proposal for reform is, in our opinion, unnecessary and unlikely to accomplish an effective regulation of the insurance industry. The task of dismantling or assimilating some or all of the current state regulatory system within a new federal system would be monumental. The ability of insurance regulators to respond to local market conditions and consumer complaints will most likely be compromised. Moreover, we are concerned that the broad powers proposed to be granted to the federal regulators would reduce the efficient impact of market forces on the rate setting process. This would not be a good outcome for American consumers.

A more effective use of federal powers to facilitate regulatory modernization is an approach that builds on the strength of the state regulatory system while providing a means to implement

uniformity and consistency in every state--Congressional promulgation of uniform national standards of regulation to be enforced by the existing state regulatory system. In theory, effective federal standards would require states to implement reforms that could bring uniformity, consistency and efficiency to insurance regulation. Federal standards could be applied in many areas of insurance regulation where there is no compelling reason for state-by-state regulatory variance.

Given the current practical barriers to the delivery of uniform and consistent state regulation, use of federally enacted national standards could enhance the process and in fact, be welcomed by many who seek to preserve state regulation. However, federal standards that merely constitute a floor over which states may enact additional regulation (such as the privacy provisions of Gramm-Leach-Bliley) leads to an inefficient mosaic of varying and inconsistent regulations. To be effective, federal standards should preempt the field and be subject to interpretation by the federal courts. In this form, Progressive would support reasonable federal standards.

Progressive's Assessment of the Best Option

From Progressive's perspective, the approach with the best chance of bringing about meaningful reform is the use of reasoned preemptive federal standards. While we believe that such federal standards can be applied in many areas, the approach is novel and should initially be limited to a few targeted issues. Specifically, we would encourage the Congress to work with interested parties on the development of a federal standards bill that addresses producer and company licensing, market conduct examinations, and speed to market.

The components of a federal standards bill need not be debated today. Needless to say, many interested parties (insurers, agents, the NAIC, NCOIL, and consumers) should participate in the process so that any federal standards bill would achieve the desired reforms without unintended negative consequences. From our perspective, federal standards should accomplish the following general objectives:

Producer and Company Licensing: procedures should be streamlined through the use of uniform applications, technology, and reliance on home state regulation.

Speed to Market: in a competitive market, rate regulation should be on a use and file basis. Rates could not be excessive, inadequate or unfairly discriminatory. Policy forms would be subject to a thirty-day prior approval.

Market Conduct: without sacrificing consumer protections, the market conduct examination process should be streamlined. Home states should take primary responsibility for market conduct review with non-domiciliary state examinations targeted on specific areas of concern. Uniform examination procedures should be adopted and the self-evaluative audit privilege should be recognized.

Federal standards are a tool that can be used broadly to encourage regulatory reform in a number of other areas. This would include issues such as privacy, e-commerce, telemarketing, records retention, policy notices, and countless others. With federal standards there are tremendous opportunities to reduce costs and enhance competition without sacrificing consumer protection.

Conclusion

Change in the insurance regulatory environment is both necessary and inevitable. The alternative is the continued imposition of needless costs that impede the ability of American insurers to compete in the global market and constitute a financial burden on American consumers. We hope that Congress will continue to act as a positive force in the regulatory reform process moving deliberately and

cautiously to ensure that any federal involvement clearly meets the interests of all stakeholders without creating unintended negative consequences.

NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

Testimony of
SENATOR KEMP HANNON

Chair, Health Committee
New York Senate

Co-Chair, NCSL Task Force to Streamline and
Simplify Insurance Regulation

On behalf of the
NATIONAL CONFERENCE OF STATE LEGISLATURES

Regarding
REFORMING INSURANCE REGULATION—MAKING THE MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

Before the
FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

UNITED STATES HOUSE OF REPRESENTATIVES

NOVEMBER 5, 2003

Testimony of Senator Kemp Hannon, New York
Co-Chair, NCSL Task Force to Streamline and Simplify
Insurance Regulation

Good afternoon. I am New York State Senator Kemp Hannon. I chair the Health Committee in the New York Senate. Since 2001, I have served as co-chair of the National Conference of State Legislatures' (NCSL) Task Force to Streamline and Simplify Insurance Regulation. I am pleased to testify before you today on state legislative efforts to streamline, simplify and coordinate insurance regulation to meet the needs of the modern economy.

On behalf of the nation's state legislatures, I would like to make four major points.

- First, insurance is a different kind of product that is best regulated at the state level. For 152 years, state insurance regulation has successfully and effectively protected consumers and ensured the safety and soundness of insurance companies operating in the United States.

- Second, state legislatures and insurance commissioners have developed a shared vision for modernizing insurance regulation while preserving the advantages of the state system. NCSL, the National Conference of Insurance Legislators (NCOIL) and the National Association of Insurance Commissioners (NAIC) have worked closely at the national level to implement this vision. States have made significant progress in critical areas and expect to achieve widespread reform in all major areas in the years ahead.

- Third, state legislatures are moving forward at the state level to enact significant statutory changes to streamline and simplify state laws. NCSL has endorsed model legislation to create a multistate system to regulate life insurance products according to uniform national standards. This is only the third time in its 28-year history that NCSL has endorsed model legislation. NCSL also has endorsed a statement of principles to guide legislative efforts to modernize property and casualty insurance rate and form

requirements. State legislatures have passed laws to provide producer licensing reciprocity and to meet and exceed federal standards for insurance information privacy. Furthermore, state legislatures are exercising legislative oversight to ensure that regulatory reforms at the state level are instituted and work.

- Fourth, NCSL believes that any federal legislation in the area of insurance regulation would be a tremendous mistake. It would endanger effective state regulation, threaten the creation of a vast, costly new federal bureaucracy, and introduce a host of unintended consequences risking consumer protections, insurer solvency, and the strength and stability of the insurance marketplace.

A Different Kind of Financial Product

Insurance serves as the cornerstone of the economy. It provides economic security for individuals and their families and allows businesses to manage the risks that are inherent in economic activity. Whereas banking and securities are about access to capital and risk-taking, insurance is a guarantee. It is a legal promise—steeped in state tort and contract law—to pay a claim if and when benefits are due, often years into the future. When the unanticipated happens or the unthinkable occurs, insurance is there to provide the money to compensate for economic loss and to assist with recovery.

Because insurance is a different kind of financial service, it requires a different kind of regulation that states are best suited to provide. Insurers charge people different rates based on personal characteristics and where they live. They also can decline to offer a policy. The very nature of insurance requires insurers to set the price for a product before they know their largest expense. Instead, insurers project costs based on prior experience and loss estimates. These unique features require a level of practical expertise and political understanding that is well established at the state level.

People turn to insurance at their most difficult and vulnerable times—after the loss of their home, health, income, or a loved one. When an insurer does not pay or acts unfairly, states regulators can intervene within days or hours when it could take a distant federal

bureaucracy weeks or months to act, if at all. For a product as personal and important as insurance, regulation closest to home makes more sense.

State Regulation is Successful and Effective

The states have proven that they effectively and successfully protect consumers and make certain that promises made by insurers are kept. State regulation ensures that rates are fair, adequate and not excessive; that policy language is clear and includes what it should; that insurers are financially sound; that claims are paid; that consumers are informed and that their complaints are investigated and resolved.

State regulation is accessible, accountable and responsive, and operates with greater efficiency than would a vast new federal bureaucracy. Decentralized authority promotes regulatory innovation and safeguards against the imposition of rigid regulatory controls that may have adverse consequences that are national rather than local in scope. Furthermore, state legislatures are uniquely positioned to set policies that accurately reflect the values and concerns of local citizens. The nation's economy as a whole benefits from regulation that serves local needs as well as regional and national markets.

Insurance Regulation for the Modern Economy

State legislatures are strongly committed to preserving the states' role as the sole regulators of the business of insurance. In taking this position, state lawmakers accept the responsibility of creating a system of regulation that meets the needs and challenges of insurance companies competing in the modern financial marketplace.

NCSL has worked closely with the NAIC to develop a shared vision for modernizing insurance regulation while preserving the many benefits of the state system. Our collaboration led to the unanimous endorsement this July by the NCSL Executive Committee of the Interstate Insurance Product Regulation Compact and a Statement of Principles for the regulation of property and casualty insurance. Furthermore, NCSL supports regulatory efforts to streamline, simplify and coordinate insurance regulation. We applaud the NAIC's "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan" to achieve

modernization in seven critical areas. State legislatures and commissioners are working together at the national level and in individual states to make this vision a reality.

Historical Background

State legislatures took the first step to modernize state systems in the early 1990s when faced with a rash of insurer insolvencies tied to the savings and loan crisis. Unfortunately, the insolvencies occurred in a handful of states where insurance regulation was weak and at a time when there was insufficient coordination among state insurance departments. In response, NCSL established a special insurance solvency task force, which collaborated with the NAIC to draft and recommend 11 model bills to strengthen state regulation, to reduce filing burdens on multistate insurers and to allow for greater coordination among state insurance departments. In the first such action in our history, in 1991, NCSL endorsed the package of model legislation, which in two years was enacted in virtually all states. This swift action by state legislatures and insurance commissioners working together at the national level successfully stemmed the tide of insolvencies and helped avert the creation of a federal insurance regulator, which we believe would have proven a terrible mistake.

Financial Modernization

In recent years, the states have joined a concerted effort to adjust insurance regulation to meet the needs of the modern integrated marketplace while maintaining and improving consumer protections. The Gramm-Leach-Bliley Financial Modernization Act of 1999 tore down Depression-era barriers and created a comprehensive framework to permit affiliations among banks, securities firms and insurance companies. Gramm-Leach-Bliley also directed state actions in a few areas while implicitly calling on states to go beyond the specific mandates of the act to modernize insurance regulation.

States accepted this challenge with remarkable vigor. In March 2000, the nation's insurance commissioners endorsed a "Statement of Intent" to make insurance regulation more effective and efficient in several defined areas. State legislatures joined regulators to meet the specific federal mandates. Since Gramm-Leach-Bliley, 48 states have passed

producer licensing reciprocity legislation and 49 states have met or exceeded the federal standard to ensure the privacy of insurance information. Equally impressive are efforts by insurance commissioners—working through the NAIC—to retool virtually every aspect of insurance regulation, from implementing a uniform electronic product filing system to standardizing company licensing applications to rewriting the handbook for market conduct exams that are used to audit and examine company practices.

Streamlining and Simplifying State Laws

NCSL recognized the importance of state legislatures taking a proactive role to modernize insurance regulation. In 2001, NCSL established the *Task Force to Streamline and Simplify Insurance Regulation* to provide a national forum for state legislatures to engage the issues facing insurance regulation in the changing financial marketplace and, if necessary, to develop and recommend model legislation. The Task Force included a diverse range of members from across the country as well as the officers of NCOIL, which provided invaluable input, assistance, research and advice to the Task Force throughout the process.

The Task Force met regularly over a two-year period with three primary objectives:

- To preserve the primacy of state insurance regulation;
- To consider reforms that would allow insurance companies to compete more effectively in the integrated financial marketplace and to respond with innovation and flexibility to evermore demanding market forces; and
- To maintain and improve consumer protection, which is the hallmark of the state system, while expanding consumers' access to new products.

The Task Force worked closely with the NAIC, industry and consumers to explore broadly the many areas of insurance regulation—including producer licensing, privacy, market regulation, consumer protection, and company licensing. Following these consultations, the Task Force identified "speed to market" issues as the area in greatest need of state legislative action. "Speed to market" refers to the ability of insurers to bring

new products to market in a timely and efficient manner according to reasonable and transparent standards.

The Task Force reached consensus on two proposals for state legislative consideration: 1) the Interstate Insurance Product Regulation Compact for the regulation of life insurance and annuity products; and 2) a Statement of Principles for the regulation of property and casualty insurance. The NCSL Executive Committee unanimously endorsed both proposals in July 2003.

Insurance Regulation Compact

One area of insurance regulation that generated early consensus was the need for a multistate system to regulate life insurance and annuity products. Although these investment-oriented policies are still insurance products and—thus—best suited for state regulation, they compete in the integrated financial marketplace against the products of banks and securities firms, which receive less rigorous regulatory review. Unlike other insurance policies, life products rely largely on actuarial tables that are national in nature. Furthermore, 50-state standards and reviews can delay consumers' access to new products, divert limited state resources, and create problems when holders of these long-term policies move from state to state. A state-based solution that brings new products to market more quickly and efficiently according to uniform national standards promises significant benefit to consumers, regulators and industry.

In March 2002, insurance commissioners endorsed the concept of an interstate compact as the vehicle for reform. Commissioners met with the NCSL Task Force throughout the summer to discuss the compact proposal. The Task Force expressed support for the concept and offered guidance to the NAIC through its process on critical elements of the proposal, including the structure of the management committee, supermajority voting for uniform product standards, and legislative participation. The NAIC adopted all of the Task Force's recommendations and continued to work with industry, consumers, and state attorneys general on the proposal during the fall. In December 2002, the NAIC

overwhelmingly adopted the Interstate Insurance Product Regulation Compact Model Act for review, input and consideration by other state officials.

The NCSL Process

Immediately following the NAIC action, the Task Force undertook a detailed review of the proposal and began to consider possible amendments to the Model Act to address legislative concerns. A notable contribution to this discussion was an extensive report submitted by the attorneys general of California, Minnesota, Missouri and Oklahoma that raised a number of important issues. Additionally, many academics, legal experts, and industry and consumer representatives provided extensive input on the Compact. The Task Force also drew upon lessons from legislative consideration of the insurance receivership compact in the early 1990s and legislative deliberations in the three states where the Compact was considered with some success in 2003.

In the end, the Task Force recommended 10 amendments. Among other things, the amendments elaborate on open meeting requirements and procedures, guarantee public inspection of compact documents, and more specifically frame authority to rule on product standard violations by insurers.

The most difficult issue surrounded language pertaining to the binding effect of the Compact on member states. The principal concern of attorneys general was potential unintended consequences of the Compact on states' general consumer protection laws, specifically unfair and deceptive trade practices laws. Assistant attorneys general from at least 22 states participated in Task Force discussions. The Task Force brokered discussions between working groups of assistant attorneys general, regulators and industry to successfully draft compromise language that achieves the purpose of the binding effect provision while effectively preserving the authority of state attorneys general. During a plenary session of all insurance commissioners in July, the NAIC without dissent revised the Compact Model Act to accept the recommendations of the NCSL Task Force. The American Council of Life Insurers also supports the revised Compact Model Act.

'Speed to Market' for Life Insurance Products

The Interstate Insurance Product Regulation Compact represents only the third time in its history that NCSL has endorsed model legislation. The first time was in 1991 to enact uniform insurance solvency regulation. The second occasion was a year ago when NCSL endorsed a multistate agreement—enacted by 20 states in 2003—to simplify the nation's sales tax laws. Once enacted by 26 states or states representing 40 percent of the nation's insurance premiums, the Compact will create a multistate system to receive, review and quickly make regulatory decisions on insurance product filings according to national uniform standards. The Compact will cover life insurance, annuity, disability income, and long-term care insurance products.

The Compact includes a few key elements. First, it will allow member states to pool their resources and expertise to approve new products but retain control over market regulation, financial solvency, claims settlement, consumer complaints, and the enforcement of consumer protections. Second, a commission with one member from each state will govern the Compact while a 14-state management committee—with membership corresponding to states' share of premium volume—will oversee daily operations. Third, supermajority-voting requirements for the approval of product standards will promote higher consumer protections in exchange for national uniformity. Fourth, states will be able to opt out of uniform product standards by legislation and regulation if they do not meet the needs of the state. Finally, a legislative committee will oversee Compact activity and make recommendations, and governors and legislatures from member states will receive regular notice of Compact actions as well as an annual report.

NCSL believes that the Compact is the best way to preserve the advantages of the state system while raising product standards and consumer protections, improving the quality of product review, and giving insurance companies the regulatory efficiency that they need to compete in the new financial marketplace. Furthermore, NCSL is committed to

working with insurance commissioners and others to enact the Compact Model Act and make "speed to market" for life insurance products a reality in the near future.

Property and Casualty Issues

NCSL also recognizes the new economic realities faced by property and casualty (P/C) insures. Because these insurance products are closely tied to local economic and geographic conditions, NCSL does not believe that a uniform regulatory approach is required. Instead, NCSL has endorsed a Statement of Principles for the regulation of P/C insurance to guide state legislative efforts to streamline, simplify and coordinate the regulation of P/C insurance.

In its Statement of Principles, NCSL encourages state legislatures to consider systems of product regulation that rely on competitive forces to determine P/C rates and promote the more efficient introduction of new products into the marketplace. States also may want to consider systems that provide commercial insurers greater flexibility to respond to the ever-changing needs of American business. However, NCSL encourages states to move toward market-based systems while preserving their authority to take action in a noncompetitive market or against rates that are inadequate or unfairly discriminatory.

NCSL believes that there exist a wide range of models for states to draw upon as they look to modernize rate and form regulation, including the NAIC Commercial Lines Modernization Model Act and the NCOIL P/C model act and others that apply to personal as well as commercial lines. Legislatures also may want to look at models in place in a wide range of states with dynamic, competitive insurance markets and consider those features best suited to the unique conditions in their state.

States Are Modernizing Property and Casualty Regulation

Nearly two-thirds of states now rely on market-based systems to regulate property and casualty insurance rates and forms and many states have added special provisions to exempt large commercial policyholders. Some form of competitive product regulation is

used in 32 states and the District of Columbia and 19 states have enacted P/C commercial lines re-engineering for more sophisticated insurance buyers.

Despite difficult insurance markets this year, several major P/C modernization efforts were enacted by state legislatures in 2003. New Jersey enacted comprehensive reform legislation to increase competition by addressing the state's excess profits and take-all-comers laws. Louisiana passed a flex-rating law for auto and homeowners insurance modeled on the South Carolina auto insurance reform of 1998. New Hampshire approved a new system that mixed the NCOIL model for personal lines and the NAIC commercial model while significantly lowering its threshold for exempt commercial policyholders. Nebraska enacted commercial lines modernization. Moreover, despite widespread cries to significantly regulate the Texas insurance market following significant volatility in the state's homeowners insurance market, the legislature adopted a market-based system, which also allows insurers to file policy forms for approval. Additionally, market-based systems either passed one chamber or showed signs of success in Florida, Georgia, Minnesota, Nevada, Rhode Island, South Carolina and Washington.

Insurance Regulatory Modernization Action Plan

The NCSL Task Force focused on "speed to market" issues because they were identified as the highest financial modernization priority and the one that required the greatest legislative involvement. As we follow-through with the Compact and P/C insurance modernization, NCSL recognizes that state legislatures also have an important role in other critical areas of reform, even those that are primary regulatory in nature.

Therefore, NCSL looks forward to working with the NAIC to implement the "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan." The seven major areas of reform in the plan include: i) consumer protection, ii) market regulation, iii) speed to market, iv) producer licensing, v) company licensing, vi) solvency regulation, and vii) change in insurance company control. We applaud the NAIC's initiative to update the principles outlined in the March 2000 "Statement of Intent" and

build upon these years of substantial improvement with a comprehensive vision to achieve widespread reform. We wholeheartedly endorse this plan.

Although the NCSL Task Force has concluded, state legislatures continue to take a proactive role at the national level. For this reason, in 2002, the NCSL established the Financial Services Standing Committee to give greater attention to banking, insurance, securities and other issues related to financial services. Representative Donna Stone, who chairs the House Economic Development, Banking and Insurance Committee in Delaware and served on the Task Force, now chairs the NCSL Committee. Representative Frank Mautino, who co-chaired the Task Force with me and chairs the House Insurance Committee in Illinois, and Representative Keith Faber, who served on the Task Force and is one of the most knowledgeable members on insurance issues in the Ohio legislature, both serve as vice chairs on the NCSL Committee. The Committee also is pleased to have Senator John Loudon, who chairs the Senate Small Business, Insurance and Industrial Relations Committee in Missouri, and Assemblywoman Patricia Wiggins, who chairs the Assembly Banking Committee in the California, serve as vice chairs on the NCSL Committee.

Federal Legislation Would Be a Mistake

I concluded my remarks with a couple comments on why state legislatures believe that any federal legislation would be a mistake. Federal intervention necessarily would undermine state consumer protections and solvency regulation—where the states have proven to be most effective. It would restrict the ability of state officials to respond to the needs of local markets, threaten the creation of a vast, costly new federal bureaucracy, and introduce a host of unintended consequences.

It is easy to theorize a perfect model of insurance regulation, but it is much more difficult to enact and establish one. As the chair of the Health Committee in the New York Senate, I have come to appreciate the unforeseen consequences of the Employee Retirement Income Security Act (ERISA) of 1974, which was the first significant federal effort in the area of insurance regulation. ERISA preempts state laws for employer-sponsored benefit

plans, which provide health benefits to the great majority of privately insured Americans. The act effectively transferred authority from the states to the Department of Labor and federal judiciary and created the system largely responsible for giving insurance a bad name. It is easy to see how similar unforeseen consequences could materialize if the federal government were to preempt or restrict state authority to regulate in the areas of life and property and casualty insurance.

Conclusion

In conclusion, insurance is a unique product. States have successfully and effectively regulated it for 152 years. State legislatures and insurance commissions are working together to streamline, simplify and coordinate state regulation while protecting consumers and preserving the advantages of the state system. We believe that state reform rather than federal legislation offers the best promise for a system of insurance regulation that meets the needs of consumers and the nation in the 21st century.

Thank you for this opportunity to offer you testimony on behalf of the nation's state legislatures. I look forward to responding to your questions.

Statement of

Markham R. McKnight, CPCU

President & CEO, Wright & Percy Insurance

on

Reforming Insurance Regulation – Making the Marketplace More Competitive for Consumers

Before the

House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

November 5, 2003
Washington, D.C.

Statement of Markham McKnight, CPCU

President, Wright and Percy Insurance, Baton Rouge, Louisiana

Before a Hearing of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"Reforming Insurance Regulation – Making the Marketplace More Competitive for Consumers"

November 5, 2003

My name is Markham McKnight, and I am the President and CEO of Wright and Percy Insurance which is headquartered in Baton Rouge, Louisiana. Our firm, founded in 1882, offers financial and risk services and insurance products to both personal and commercial customers throughout the southeastern United States. In a development that I think is indicative of the growing convergence that is taking place in the financial services industry in the wake of the passage of the Gramm-Leach-Bliley Act, Wright & Percy Insurance was acquired in May, 2003, by BancorpSouth, Inc., a bank holding company with commercial banking and financial services operations in Mississippi, Tennessee, Alabama, Arkansas, Texas and Louisiana. I retain the title of president and CEO of Wright & Percy for BancorpSouth Insurances Services, Inc.. I believe that this merger will allow both Wright and Percy and Bancorp South to better serve our customers. My initial exposure to the dual-chartering system for banks also has been a revelation and has reaffirmed my personal commitment to the enactment of an optional federal charter for insurers. I also am privileged to be serving as the Chair of the Government Affairs Committee of The Council of Insurance Agents + Brokers ("The Council").

I'd like to thank you, Chairman Baker, for giving me the opportunity to testify before the Subcommittee today. I would like to commend you for holding this series of hearings to examine the shortcomings in the state-based insurance regulatory system and to explore the different approaches that have been advanced to modernize that regulatory system and whether the National Association of Insurance Commissioners' action plan to achieve such modernization without Congressional intervention is viable. One of the reasons I chose to become active with The Council is that it has been a pioneer within our industry on the modernization issue – 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 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 modernization. I thank you, Mr. Chairman, and other members of this committee on both sides of the aisle for your active support of the NARAB provisions during the conference on the Gramm-Leach-Bliley Act.

NARAB was a true provision of modernization in the Gramm-Leach-Bliley Act. Were it not for the tenacious support and initiative from you and Congresswoman Kelly, and the leadership of Chairman Oxley, things

assuredly would not be changing for the better - particularly at their current pace. This initiative was bipartisan, and provides a very good model for a carrot-and-stick, goals-and-timetables approach that can effectively move insurance regulation forward toward goals of efficiency.

The NARAB approach to regulatory modernization is but one of the approaches that your Subcommittee has been examining in these hearings. I have been leading an effort to study the different routes for achieving modernization in the insurance regulatory process. To that end, The Council's Foundation for Agency Management Excellence (FAME) last year commissioned an independent study of the economic costs and benefits of these various proposals (the "FAME Study"). While it is abundantly clear that the current system of state-by-state regulation is not working, we wanted to see a full, economic analysis of the alternatives for reform. The study, entitled "Costs & Benefits of Future Regulatory Options for the U.S. Insurance Industry," provides an in-depth examination of the pros and cons of the regulatory options available for oversight of the business of insurance. The study was released during the hearing you held to examine these issues last year, and I hope that the study has served as a useful tool as the Subcommittee has continued its examination of various regulatory alternatives.

Even though the states have made some strides in recent years in simplification and streamlining – thanks to the enactment of the NARAB provisions of Gramm-Leach-Bliley – there are still several problem areas in the interstate licensing process that cost agents and brokers time and money unnecessarily. Insurance companies also face problems in doing business on a multi-state basis, and recent efforts by the states to streamline rate and policy form approval processes have not proven to be very successful. These continuing issues with the state-by-state regulatory process lead us to the following conclusion: relief is needed, and it is needed now. I urge the Committee to enact relief, and to do it soon.

I believe that it is critical to the long-term viability of the U.S. insurance industry that Congress pass legislation creating an optional federal charter for insurers. Broader reforms to the insurance regulatory system are necessary to permit the industry to operate on a more efficient basis. Such broader reforms, like an optional federal charter, are also necessary to enable the insurance industry to compete in the larger financial services industry and also to be able to compete internationally. There also is a more immediate need, however, for reforms that cannot wait for the resolution of the federal charter debate. I would like to focus on three areas that could greatly benefit from immediate reforms that would be relatively easy to implement.

1. Make The NARAB Licensing Reciprocity Requirements Apply To All 50 States

The NARAB provisions included in the Gramm-Leach-Bliley Act required that at least 29 States enact either uniform agent and broker licensure laws or reciprocal laws permitting an agent or broker licensed in one State to be licensed in all other reciprocal states simply by demonstrating proof of licensure and submitting the requisite licensing fee.

The NAIC pledged not only to reach reciprocity in producer licensing, but also to reach uniformity in producer licensing as their ultimate goal. The NAIC amended its Producer Licensing Model Act (PLMA) to meet the NARAB reciprocity provisions, and worked to get the PLMA enacted in all licensing jurisdictions. As of today, 47 states have enacted some sort of licensing reform. Most of those states have enacted the PLMA, but four states have enacted only the reciprocity portions of that Model Act. Of the states that have enacted the PLMA, there are several states that have deviated significantly from the original language of the Model Act. One state, Florida, has enacted licensing reform that in no way resembles the PLMA. And Florida is joined by California as the largest of states in terms of insurance premiums written that have not enacted legislation designed to meet the NARAB reciprocity threshold at all.

The NAIC has now officially certified that a majority of states have met the NARAB reciprocity provisions, thereby averting the creation of NARAB. While that is a commendable accomplishment, there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions – and I am not sure that the NAIC will be able to meet that goal. This is especially troubling, given the threat of federal intervention that was implicit in the NARAB provisions of Gramm-Leach-Bliley.

Indeed, until just last month, the State of Florida completely barred non-residents from being licensed to sell surplus lines products to Florida residents or resident businesses and required non-resident agents or brokers who sold a policy of an admitted company to a Florida resident or resident business to pay a resident agent a mandated "countersignature fee" in order to complete that transaction. These practices have been terminated only because The Council filed a lawsuit and was granted summary judgment on its claims that these statutory requirements violated the constitutional rights of its members. The State has opted not to appeal. We should not have to resort to lawsuits, however, to defeat these protectionist laws and to put ourselves in a position to serve our clients and to do so in an efficient manner. Three other jurisdictions – Nevada, South Dakota and West Virginia – currently retain their protectionist countersignature laws.

I do not believe that the NAIC – despite its ambitious reform agenda – is in a position to force dissenting States to adhere to any standards it sets. Congress can, however, by mandating that all 50 States enact uniform licensure laws or laws permitting an agent or broker licensed in one State to be licensed in all other States on a reciprocal basis and preempting all State insurance laws that discriminate against non-resident agents and brokers as the Florida provisions were found to have done.

Under the NARAB provisions of the Gramm-Leach-Bliley, if the threshold requirements are not satisfied, then the Act provided for the formation and organization of the National Association of Registered Agents and Brokers. These provisions were modeled after the National Association of Securities Dealers. If new, 50 State requirements were enacted and they were not satisfied, then the National Association of Registered Agents and Brokers would function in a manner similar to the NASD if the Gramm-Leach-Bliley Act provisions providing for its creation and operation were maintained. It would create a national licensing clearinghouse where multistate insurance producers could obtain multiple licenses through a single point of filing. It would also likely set a higher standard for licensure than currently exists in any one state, but one that is based on the professional qualifications of the individual. The National Association of Registered Agents and Brokers would also provide a centralized enforcement mechanism that would enable regulators to get bad actors out of the system sooner rather than later.

A large portion of the regulation of registered securities representatives is done through the NASD, which is a self-regulatory organization established by Congress and overseen by the Securities and Exchange Commission. Registered securities representatives must still procure licenses in all states in which they wish to sell securities, but they can procure those licenses by going through one central location – the NASD's Central Registration Depository (CRD). The CRD processes registrations for the NASD and for six other securities exchanges. An individual seeking licensure with multiple organizations and/or states need only submit a uniform registration form and payment of the requisite fees. The NASD also provides a centralized authority for the enforcement of securities laws and the development of national enforcement policies. The NASD's Enforcement Division prosecutes securities violations discovered by the NASD and also receives enforcement referrals from the SEC and the various state securities regulators.

Self-regulatory organizations (SROs) like the NASD provide a good model that could easily be modified to address the regulation of insurance producers. SROs are used quite commonly to regulate professional activities. For example, state bar associations are SROs that provide oversight of the legal profession. The concerns with state-by-state licensing for insurance producers have never had anything to do with state regulation of insurance producers. Rather, the concerns have arisen from the myriad of idiosyncratic requirements that often have little or

nothing to do with the professionalism of our members. A single set of licensing requirements and rules of conduct that are meaningful in terms of expertise and proficiency would be highly preferred, even if that means meeting the highest of standards that currently exist.

The Subcommittee should strongly consider the use of an SRO to address the continuing problems in interstate producer licensing, whether as part of an optional federal charter bill or as part of any other interim reforms that the Subcommittee would consider. Using a supervised SRO to regulate industry activities might result in significant efficiencies and savings for consumers without diminishing the consumer protections in place today.

It is important to note that nothing in the federal securities laws authorizes any specific entity to act as the SRO for securities brokers; rather it provides for the creation of SROs to regulate securities broker/dealers subject to SEC oversight. This same approach could work well in the insurance industry, as it would permit each segment of the producer marketplace (life, health, and property/casualty) to address its own unique issues. The supervising regulator could be housed in either an independent commission or as a part of an existing agency.

The SRO concept fits well with the optional federal charter proposals advanced by several of the groups who have already testified before this Subcommittee. I hope that you would consider adding it to any optional federal chartering legislation drafted by the Subcommittee. The SRO concept, however, also is a good example of a goal that could be achieved as an interim step towards optional federal charter legislation.

2. Speed To Market

There are some other problems with the state-by-state system of insurance regulation that deserve immediate attention and that could also be stepping stones in the path towards the optional federal charter. While these problems appear to affect insurance companies more than insurance agents and brokers, we would argue that the restraints imposed by the state-by-state regulatory system on these areas affect our members just as much as the companies.

My agency – like most Council members – sells and services primarily commercial property/casualty insurance. This part of the insurance industry is facing some severe challenges today due to a number of factors, including the losses incurred as a result of the terrorist attacks on September 11, 2001; increased liabilities for asbestos, toxic mold, D&O liability and medical malpractice; and years of declining investment returns and consistent negative underwriting results. Some companies have begun to exit different insurance markets as they realize that they can no longer write these coverages on a break-even basis, let alone at a profit. The end result is increased

prices and declining product availability to consumers. This situation is only being exacerbated by the current state-by-state system of insurance regulation.

The FAME study mentioned earlier in my testimony notes that the current U.S. system of regulation can be characterized as a prescriptive system that generally imposes a comprehensive set of *ex ante* constraints and conditions on all aspects of regulated entities' business operations. Examples of *ex ante* requirements include things like prior approval or filing of rates and policy forms. The prescriptive approach is designed to anticipate problems and prevent them before they happen. However, this approach to regulation hinders the ability of the insurance industry to deal with changing marketplace needs and conditions in a flexible and timely manner. Consequently, it also hinders the ability of regulators to quickly address emerging problems. The prescriptive approach to regulation also encourages more regulation than may be necessary in some areas, while directing precious resources from other areas that may need more regulatory attention.

It is also important to note that states wishing to do business on a national basis must deal with 51 sets of *ex ante* requirements. This tends to lead to duplicative requirements among the jurisdictions, and excessive and inefficient regulation in these areas. Perhaps the best (or worst, depending upon your perspective) example of this are the policy form and rate pre-approval requirements still in use in many states. Over a dozen states have modernized the commercial insurance marketplace for rates and forms, meaning that there are no substantive regulatory approval requirements in these areas at all. Other states, however, continue to maintain pre-approval requirements. Indeed, some studies have shown that it can take as much as two years for a new product to be approved for sale on a nationwide basis. Banking and securities firms, in contrast, can get a new product into the national marketplace in 30 days or less. The lag time for the introduction of new insurance products is unacceptable, and it is increasingly putting the insurance industry at a competitive disadvantage as well as undermining the ability of insurance consumers to access products that they want and need.

Congress should address these problems either by limiting the States' pre-approval authority directly, or by establishing some sort of NARAB-like incentives to encourage the States to do it on their own (or have it done for them should they fail).

3. Increasing Access To Alternative Markets

In the last year, high rates for property and casualty insurance have been a serious problem for many mid-sized and larger commercial firms. Congress should explore ways that alternatives to the traditional, regulated

marketplace can be fostered to provide a viable alternative for sophisticated insurance consumers. Two mechanisms that help stem increasing rates are the use of surplus lines products and risk retention groups.

Surplus Lines. For commercial property and casualty insurance, more and more business is done through the surplus lines marketplace. A surplus lines product is an insurance product that is 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. The products tend to be more efficient because the issuing companies are more efficiently regulated and because the policies are manuscripted and therefore need not comply with state form and rate requirements. In essence, the insured goes to wherever the insurer is located to purchase the coverage. The insurer may be in another State, or it may be in Great Britain, Bermuda or another country. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers.

Although the purchase of this type of insurance is perfectly legal in all States, many States have enacted two different types of requirements that can greatly limit is usefulness. First, some States either completely prohibit (like Florida did) or greatly hinder non-resident brokers from placing surplus lines coverage for a risk located in those States. Second, almost every State imposes a premium tax obligation for surplus lines premiums. The problem in this regard is that the States have conflicting rules with respect to the portion of the premium on which the tax must be paid. Some States, for example, dictate that tax must be paid on 100 percent of the premium even if only a small percentage of that premium is associated with risks being insured in those States. These problems are particularly problematic when insuring companies with a national presence that could most benefit from the use of a surplus lines product but that must grapple with the morass of conflicting regulation to realize such benefits.

My hope is that Congress can act to alleviate these problems by preempting the State requirements that discriminate against non-resident brokers in any way and by creating some sort of incentive or requirement for the States to rationalize their irrational surplus lines premium tax formulae.

Risk Retention Groups. Enacted in 1981, the Product Liability Risk Retention Act was developed by Congress in direct response to the insurance "hard market" of the late 1970s. The current version of the Act – the Liability Risk Retention Act of 1986 – was enacted in response to the "hard market" of the mid-1980s and expanded the coverage of the Act to all commercial liability coverages. Risk Retention Groups (RRGs) created under the Act are risk-bearing entities that must be chartered and licensed as an insurance company in only one State and then are permitted to operate in all States. They are owned by their insureds and the insureds are required to have similar or related liability exposures; RRGs may only write commercial liability coverages and only for their

member-insureds. The rationale underlying the single-State regulation of RRGs is that they consist only of "similar or related" businesses which are able to manage and monitor their own risks. The NAIC has recognized that the purpose of Risk Retention Groups is to "increase the availability of commercial liability insurance" and it has been a success in that regard as it has created an alternative that many have ceased. Congress should expand the availability of RRGs by expanding the Act to allow for the insuring of property damage as well as liability exposures. This would provide another alternative for businesses seeking economical insurance solutions in difficult economic times for the insurance industry.

Moving Forward?

The FAME study notes that all of the regulatory modernization efforts put forward by the NAIC in the past several years have been the direct result of major external threats – either the threat of federal intervention, or the wholesale dislocation of regulated markets. It concludes that there is no guarantee that the state-based system will adopt further meaningful reforms without continued external threats to its jurisdiction, and offers the states' progress on producer licensing reform as a prime example. I wholeheartedly agree with this conclusion, and urge this Subcommittee to continue to press the states to enact meaningful reforms to the insurance regulatory system.

Chairman Baker, I believe that you and others on your Subcommittee were absolutely on target when you talked about the need for immediate Congressional action to address the continuing problems in the state-based regulatory system. While I ultimately support the enactment of an optional federal charter, I know that we can't wait for that debate to play out before getting some relief from duplicative and inefficient regulation that has little impact on the effectiveness of the insurance regulatory system. There are several targeted reforms that the Congress could address now that will benefit not only the insurance industry but also the consumers we serve. As discussed above, the areas deserving immediate attention include further reforms to the producer licensing system, addressing the speed-to-market shortcomings in the current state system by eliminating prior approval of rates and policy forms, similar to the successful model used in Illinois, and enacting legislation that could expand access to alternative insurance marketplaces for commercial insureds.

Mr. Chairman, you have asked witnesses at the past two hearings to give you a timeline for achieving additional reforms in the insurance regulatory system, but you were not able to get a direct answer. I'd like to give you my suggestions for how to proceed with future reforms.

The reforms to the producer licensing system, the speed-to-market reforms, and the measures designed to expand access to alternative marketplaces mentioned above need to occur as soon as possible – preferably, within the next

year. These reforms will provide the most immediate relief from inefficient and duplicative regulation for the industry.

The NAIC is working on further reforms that are currently in their fledgling stages, like an interstate compact to facilitate a single point of filing and approval for life insurance products. Additionally, the NAIC is in the process of developing standards for coordination of market conduct examination. While we support the efforts of the NAIC in these areas, our experience with NARAB cautions us to be wary of their success. Eighteen months ago, a representative of The Council testified before this Subcommittee and suggested that the Subcommittee continue to monitor the progress on these initiatives over the next 18 months and to be ready to act to implement reforms in these areas if the states' efforts should fail to take hold. That 18 months has now come and gone and the states' efforts have failed to take hold; Congress should act now to fill the gap.

I urge the Subcommittee, however, to continue with its work on the optional federal charter even as it develops interim reforms. The enactment of an optional federal charter is essential to the U.S. insurance industry's long-term survival. While there are more immediate reforms that can be made to the insurance regulatory system, those reforms in no way preclude the ultimate need for an optional federal charter. The FAME study mentioned above has come to the same conclusion:

> Regardless of whether the states undertake significant further reforms, the inexorable trend seems to lead away from continued state regulation. If states fail to undertake significant reforms, the state system will become increasingly unsuitable to the current environment and generate tremendous pressure for wholesale change. If, on the other hand, the states undertake significant reforms and achieve a greater degree of uniformity, reciprocity and comity, those reforms will help set the stage for a further move toward federal regulation.

There is one other consideration that the Subcommittee should keep in mind as it begins its work on reforming the insurance regulatory system. It is critical for the Subcommittee to continue to monitor the progress made by the states in all areas of regulatory modernization. As noted above, improvements in the state insurance regulatory system have come about largely because of the leadership of this Committee, and through your continued oversight of the review process. I thank you for your attention to this critical issue, and also thank Chairman Oxley and Rep. Kanjorski for their leadership in this area. I hope that you will continue these efforts, as they benefit not only the insurance industry, but also the consumers that we serve.

In sum, Chairman Baker, I strongly agree with your early statements that Congress needs to consider short-term and long-term solutions. We need state-based reforms, we need continued federal oversight and pressure to reach uniformity in state laws, and we need you to continue laying the foundation for an optional federal charter. I urge

this Subcommittee to begin work now on those reforms that are easily obtainable in the short-term – such as further producer licensing reforms, speed-to-market, and increasing access to alternative markets – as well as the long-term reforms, like an optional federal charter, that may require further examination and debate before enactment. I thank you, Mr. Chairman, for the opportunity to testify on this important issue, and stand ready to assist you in meeting these important goals.

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises

Committee on Financial Services
United States House of Representatives

Regarding:
State Insurance Regulators' ***A Reinforced Commitment: Insurance Regulatory Modernization Action Plan***

Wednesday, November 5, 2003

Mike Pickens
Arkansas Insurance Commissioner
2003 President,
National Association of Insurance Commissioners

Testimony of Mike Pickens, 2003 President
National Association of Insurance Commissioners

Introduction

Good morning, my name is Mike Pickens. I am the Arkansas Insurance Commissioner. This year I am serving as President of the National Association of Insurance Commissioners (NAIC). I am pleased to be here on behalf of the NAIC and its members to provide the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises with an overview and update of our efforts to modernize state insurance supervision to meet the true demands of the 21st Century.

Today, I would like to make three basic points:

- First, NAIC and the states are well underway in our efforts to modernize state regulation where improvements are needed, while preserving the benefits of local consumer protection that is the real strength of state insurance regulation. With NAIC's adoption in September 2003 of ***A Reinforced Commitment: Insurance Regulatory Modernization Action Plan***, state regulators are on time and on target to accomplish changes needed to establish an efficient national system of insurance regulation in the United States. In some areas, our goal is to achieve national uniformity because it makes sense for both consumers and insurers. In areas where different standards among states are justified because they reflect regional consumer protection needs, we are harmonizing state regulatory procedures to facilitate compliance by insurers and agents doing business in those markets.

- Second, insurance is a complex commercial product that is very much different from banking and securities. Consequently, the process for regulating insurance products must also be different. Insurance policies are essentially financial guarantees that are necessarily rooted in the contractual and tort laws of each state

to provide protection against unexpected and unavoidable losses that can cripple the lives of individuals, families, and businesses. In doing so, insurance products inevitably touch a host of important and often controversial social issues that require statutory code language in every state.

- Third, we strongly believe effective national regulation does not mean federal regulation. Involving the federal government will not simplify the complexity of insurance issues, nor diminish their number, nor smooth the process of regulating them. Instead, federal intervention in supervising insurance will simply add additional layers of harmful uncertainty, confusion, and cost for policyholders and claimants regarding who is in charge of the payment system when they are most vulnerable to the stresses of life's disasters and personal losses. Any federal legislation dealing with insurance regulation carries the risk of undermining state consumer protections through unintended or unnecessary preemption of state laws and regulations. Creating an optional federal charter and its related regulatory apparatus would have a serious negative impact on the state regulatory system, including our efforts to make improvements in areas sought by proponents of a federal charter. Ultimately, a federal regulator will adversely affect necessary state premium taxes and other revenues, which totaled $16.7 billion in 2002.

State Regulatory Modernization: On Time and On Target

The state regulatory system is inherently strong when it comes to protecting consumers because we understand local needs and local market conditions. However, we agree with critics that there is a need to make the system more uniform, reciprocal, and efficient. In March 2000, the nation's insurance commissioners committed to modernizing the state system by unanimously endorsing an action plan entitled ***Statement of Intent – The Future of Insurance Regulation***. Working in our individual states and collectively through the NAIC, we have made tremendous progress in achieving an efficient, pro-competitive-market regulatory system for the business of insurance. Following is a snapshot of state regulators' unprecedented accomplishments.

Producer Licensing and Reciprocity

- Adopted the Producer Licensing Model Act (PLMA) that 49 states have enacted.

- By year-end 2002, 36 states had implemented State Licensing Reciprocity, far exceeding the federal mandate. To date, 41 states now implement SLR.

- The NAIC's affiliate, the National Insurance Producer Registry (NIPR), created the Producer Database, which holds information relating to over 3 million insurance agents and brokers. 50 states, the District of Columbia, and Puerto Rico now use the Producer Database to share information. 1,200 insurers also utilize it.

- 15 states now use the NIPR Gateway, a system that links state regulators electronically with insurance companies to facilitate the exchange of producer information. NIPR allows for the exchange of non-resident license applications, appointment renewals and termination information.

- Created a streamlined company licensing system via uniform filing requirements and electronic processing, called the Uniform Certificate of Authority Application (UCAA). 51 jurisdictions now accept the UCAA licensing application.

Speed to Market

- Created the System for Electronic Rate and Form Filing (SERFF) in 2001.

- As of September 30, 2003, more than 55,000 filings were submitted via SERFF to the states, a 120% increase over all filings in 2002. Approximately 50 percent of SERFF filings are property/casualty, 40 to 45 percent are life, and the balance are health. The 2003 goal is 75,000 filings.

- Total number of insurance companies licensed to use SERFF now exceeds 950, including major players such as Prudential, Liberty Mutual, Manulife, The Hartford and Zurich American.

- To date, 49 states and the District of Columbia accept property/casualty filings via SERFF, 48 jurisdictions accept life insurance filings via SERFF, and 41 jurisdictions accept health insurance filings via SERFF.

- Our goal is all states accepting rate and form filings via SERFF, for all lines of insurance and all filing types, by December 31, 2003.

- Average turnaround time for filings made via SERFF is only 17 days.

Market Conduct and Consumer Protection

- Drafted the Uniform Examination Outline

- 42 states currently certify compliance with two or more of the following exam areas: scheduling, pre-exam planning, procedures, and reports.

- Created the Consumer Information Source (CIS) link on the NAIC Web site, allowing consumers to file complaints electronically, research complaint history of insurance companies and to search and download information on selected insurance companies.

Reinforcing the State Commitment: The NAIC's 2003 Regulatory Action Plan

State regulators have now taken the next step in achieving efficient national regulation by developing specific program targets and establishing a common schedule for implementing them. At the NAIC's Fall National Meeting in September 2003, state regulators adopted ***Reinforced Commitment: Insurance Regulatory Action Plan***. This

landmark document – the result of lengthy discussions and negotiations – puts the states on a track to reach all key modernization goals at scheduled dates ranging from December 31, 2003 to December 31, 2008.

Significantly, these specific regulatory program targets were developed with extensive input from industry and consumer representatives who are active in the NAIC's open committee process. To our knowledge, every legitimate complaint regarding inefficiency and redundancy in the state system has been effectively addressed by our new regulatory action plan that will phase-in the necessary improvements over the next five years. Even if an alternative federal regulatory system were set up tomorrow, there is no way it could achieve these improvements on a schedule that comes close to the aggressive timetable which state regulators have adopted voluntarily.

The NAIC is not alone in endorsing state action as the basis for achieving regulatory modernization. We are joined in our resolve by the National Conference of State Legislatures, the National Conference of Insurance Legislators, and the Council of State Governments. Each of these state groups has recently passed official resolutions supporting state regulatory reforms and opposing federal legislation that would preempt or interfere with state regulation. Copies of these resolutions are attached to this statement as Attachment B.

Thus we have a specific action plan, a set timetable for implementing it, and joint support from other state officials who are responsible for changing state laws to get the job done. The reasons for adopting the goals in the new NAIC regulatory action plan are explained well in the document's introduction:

> States have met the challenge of regulating a national and international business on a fifty state basis using a number of innovative mechanisms. The NAIC Financial Regulation and Accreditation Standards Program has served the insurance industry and consumers well for the past fourteen years. The program

has ensured coherent financial solvency oversight and has proven to be a highly effective approach within the state-based system. As licensing states substantially defer to the insurer's home state for nearly all aspects of financial and solvency regulation, the state solvency system promotes intelligent and efficient use of finite regulatory resources. By focusing on those insurers that pose solvency risks, this system has strengthened protection of policyholders and benefited both the insurance industry and policyholders by minimizing regulatory costs. While NAIC members continue to seek greater effectiveness and improvements to the financial standards of the program, it can serve as a template for market based regulatory reforms.

Using this state-based solvency system as a model, the members of the NAIC will design and implement similar uniform standards for producer licensing, market conduct oversight, and rate and form regulation. In addition, the NAIC will expand the existing financial regulation framework to institute true uniformity and reciprocity in company licensing requirements, and further enhance financial condition examinations, and changes of an insurer's control during mergers and acquisitions.

Creating a truly national – but not "federal" – system of regulation has been a long-term goal of NAIC and state insurance regulators. What's new is we now have a realistic, detailed action plan for meeting that goal.

Specific Action Goals in the NAIC Plan

The NAIC's 2003 action plan with current updates on the progress made is appended as Attachment A. It's useful to focus on the NAIC's declared principles and goals reflecting our commitment to continue modernizing insurance regulation:

I. Consumer Protection

"An open process ... access to information and consumers' views ... our primary goal is to protect insurance consumers, which we must do proactively and aggressively, and provide improved access to a competitive and responsive insurance market."

II. Market Regulation

"Market analysis to assess the quality of every insurer's conduct in the marketplace, uniformity, and interstate collaboration ... the goal of the market regulatory enhancements is to create a common set of standards for a uniform market regulatory oversight program that will include all states."

III. Speed-to-Market for Insurance Products

"Interstate collaboration and filing operational efficiency reforms ... state insurance commissioners will continue to improve the timeliness and quality of the reviews given to insurers' filings of insurance products and their corresponding advertising and rating systems."

IV. Producer Licensing

"Uniformity of forms and process ... the NAIC's broad, long-term goal is the implementation of a uniform, electronic licensing system for individuals and business entities that sell, solicit or negotiate insurance."

V. Insurance Company Licensing

"Standardized filing and baseline review procedures...the NAIC will continue to work to make the insurance company licensing process for expanding licensure as uniform as appropriate to support a competitive insurance market."

VI. Solvency Regulation

"Deference to lead states ... state insurance regulators have recognized a need to more fully coordinate their regulatory efforts to share information proactively, maximize technological tools, and realize efficiencies in the conduct of solvency monitoring."

VII. Change In Insurance Company Control

"Streamline the process for approval of mergers and other changes of control."

NAIC members understand these goals present difficult challenges. However, with the active support and participation of governors and state legislators, and other law and policymakers, as well as industry and consumer advocates, we are confident NAIC member states will achieve these goals.

Insurance is a Complex Commercial Product that Demands Local Regulation

Paying for insurance products is one of the largest consumer expenditures of any kind for most Americans. Figures compiled by the NAIC show that an average family can easily spend a combined total of $4,500 each year for auto, home, life, and health insurance coverage. This substantial expenditure – often required by law or business practice – is typically much higher for families with several members, more than one car, or additional property to insure. Consumers clearly have an enormous financial and emotional stake in making sure insurers keep the promises they make to us.

Protecting insurance consumers in a world of hybrid institutions and products must start with a basic understanding that insurance is a different business than banking and securities. Insurance is a commercial product based upon subjective business decisions such as these: Will an insurance policy be offered to a consumer? At what price? What are the policy terms and conditions? Is a claim filed by a policyholder valid? If so, how much should the customer be paid under the policy terms? All of these subjective business decisions add up to one absolute certainty: Insurance products can generate a high level of consumer backlash and customer dissatisfaction that requires a higher level of regulatory resources and responsiveness.

As regulators of insurance, state governments are responsible for making sure the expectations of American consumers – including those who are elderly or low-income – are met regarding financial safety and fair treatment by insurers. State insurance commissioners are the public officials who are appointed or elected to perform this consumer protection function. Nationwide in 2002, we employed more than 13,000 regulatory personnel and spent $947 million to be the watchful eyes and helping hands on

consumer insurance problems. We helped consumers collect tens of millions of dollars in claims payments. The states also maintain a system of financial guaranty funds that cover personal losses of consumers in the event of an insurer insolvency.

It is important for Congress to note that the entire state insurance system is authorized, funded, and operated at absolutely no cost to the federal government.

There have been charges from some industry groups that the state regulatory system is inefficient and burdensome, and that a single federal regulator would be better. However, the NAIC and its members do not believe the consumers we serve each day think we are inefficient or burdensome when compared to the agencies and departments of the federal government. During 2001, we handled approximately 3.6 million consumer inquiries and complaints regarding the content of their policies and their treatment by insurance companies and agents. Many of those calls were resolved successfully at little or no cost to the consumer.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each state. The policy itself is a contract written and interpreted under the laws of each state. When property, casualty, and life claims arise, their legitimacy and amounts must be determined according to individual state legal codes. Consequently, the constitutions and statute books of every state are thick with language laying out the rights and responsibilities of insurers, agents, policyholders, and claimants. State courts have more than 100 years experience interpreting and applying these state laws and judgments.

There is no way the federal government could possibly replicate the specific expertise of state legislatures, regulators, and courts to successfully interpret the contractual and tort laws of 50 states and the District of Columbia. Moreover, there is no reason for the federal government to do so when the states have a specific modernization plan and timetable to get the job done.

Federal Legislation Must Not Undermine State Modernization Efforts

The NAIC and its members believe Congress must be very careful in considering potential federal legislation to achieve modernization of insurance regulation in the United States. Even well-intended and seemingly benign federal legislation can have a substantial adverse impact on existing state laws and regulations designed to protect insurance consumers. Because federal law preempts conflicting state laws under the United States CONSTITUTION, hastily drafted or vague federal laws can easily undermine or negate important state legal protections for American consumers.

When Congress passed the Gramm-Leach-Bliley Act (GLBA) in 1999, it acknowledged once again that states should regulate the business of insurance in the United States, as set forth originally in the McCarran-Ferguson Act. There was a careful statutory balancing of regulatory responsibilities among federal banking and securities agencies and state insurance departments, with the result that federal agencies would not be involved in making regulatory determinations about insurance matters.

Even though Congress tried very hard in GLBA to craft language that would not unnecessarily preempt state laws, there have already been disagreements about the extent to which federally-chartered banks may conduct insurance-related activities without complying with state laws. Under GLBA, no state law may "prevent or significantly interfere" with the ability of a federally-chartered bank to conduct insurance-related business permitted by GLBA. Federally-chartered banks, with support from OCC, are aggressively asserting their perceived rights under GLBA to preempt important state consumer protections and conduct insurance-related business unhindered by state laws. The limited entry of federally-chartered banks into insurance has thus become a source of uncertainty, dispute and an un-level playing field, despite the best efforts of Congress to avoid this very result.

We fully expect that creating a federal charter for insurers, along with its large, complex, and costly federal regulatory structure, will cause far greater problems for states and

insurance regulation in general than those resulting from the GLBA provisions dealing with banks. Federally-chartered insurers would certainly insist state laws involving solvency and market conduct cannot "prevent or significantly interfere" with their federally-granted powers to conduct insurance business anywhere in the United States. A federal insurance charter with its associated laws and regulations must necessarily parallel every aspect of existing state laws and regulations, meaning potential conflicts between state and federal laws will likely occur across the board. The result would be years of protracted, costly litigation, as well as market and regulatory confusion that will benefit the legal community rather than insurance providers and consumers.

One of the great strengths of state insurance regulation is the fact it is rooted in other state laws that apply when insurable events occur. The NAIC urges Congress to avoid undercutting state authority in considering any federal legislation that would preempt important consumer protections or create a federal insurance charter. Federal laws that appear simple on their face can have devastating consequences for state insurance departments trying to protect the public.

The Impact of Federal Chartering on State Regulation Will Not Be "Optional"

Some industry representatives have said a federal charter merely adds an optional choice to the insurance regulatory system in the United States, and that it would not seriously affect the existing state system. In America's heartland, folks might refer to such claims as "hogwash." A federal charter may be optional for an insurer choosing it, but the negative impact of federally-regulated insurers will not be optional for consumers, producers, state-chartered insurers, state governments, and local taxpayers who are affected, even though they have little or no real say in the choice of a federal charter.

Let's be clear about the impact of a federal insurance regulator upon state regulation and our ability to protect consumers: The federal government is not an equal regulatory partner because it can preempt state laws and regulations. This simple fact contradicts the very foundation of insurance in the United States; because insurance products are

uniquely intertwined and dependent upon state law for everything from underwriting standards, to pricing, to claims procedures, to legal resolution of disputes. There is no logical or practical way to divorce insurance regulation from the state laws that give rise to we consumers' insurance products.

Despite our different sizes, geography, and market needs, states work together through the NAIC as legal equals under the present system. We find solutions as a peer group through extensive discussion and debate, give-and-take and mutual respect, knowing that no single state can force its own will over the valid concerns and objections of other states. Keeping in mind the original purpose of regulation is to protect all of us consumers, we believe this participatory democracy and state decision-making, based upon the political and business realities of local markets, is a major strength of the state-based system for protecting our fellow consumers and regulating insurers and agents.

A federal insurance regulator would not be just another member of NAIC. Instead, it would be a super-agency with power to intervene and overrule every state government and territory under United States jurisdiction. The local needs and wants of citizens protected under state laws would be subjugated to the national agenda of insurers and regulators located "Inside-the-Beltway."

Ultimately, a federal charter and its regulatory system would result in at least two separate insurance systems operating in each state. One would be the current department of insurance established and operated under state law and government supervision. This system will continue responding directly to state voters and taxpayers, including the statewide election of the insurance commissioner in twelve states.

A second system would be a new federal regulator with zero experience or grounding in the local state laws that control the content of insurance policies, claims procedures, contracts, and legal rights of citizens in tort litigation. Nonetheless, this new federal regulator would undoubtedly have the power to preempt state laws and authorities that disagree with the laws that govern policyholders and claimants of state-chartered

insurers. At the very least, this situation will lead to consumer, market and regulatory overlap and confusion. At worst, it will lead to varying levels of consumer protection, perhaps even a "race to the bottom" to lower consumer protection standards, based upon whether an insurer is chartered by federal or state government.

Granting a government charter for an insurer means taking full responsibility for the consequences, including the costs of insolvencies and consumer complaints. The states have fully accepted these responsibilities by covering all facets of insurance licensing, solvency monitoring, market conduct, and handling of insolvent insurers. The NAIC does not believe Congress will have the luxury of granting insurer business licenses without also being drawn into the full range of responsibilities and hard-hitting criticism -- fair and unfair – that go hand-in-hand with a government charter to underwrite and sell insurance. Furthermore, we doubt states will be willing to accept responsibility for the mistakes or inaction of a federal regulator by including federal insurers under state guaranty funds and other important, proven consumer protection laws.

Conclusion

The system of state insurance regulation in the United States has worked well for 125 years. State regulators understand that protecting America's insurance consumers is our first responsibility. We also understand commercial insurance markets have changed, and that modernization of state insurance standards and procedures is needed to facilitate less costly and less burdensome regulatory compliance for insurers and producers.

We respectfully request Congress and insurance industry participants to work with us to implement the specific improvements set forth in state regulators' ***A Reinforced Commitment: Insurance Regulatory Modernization Action Plan*** through the state legislative system. This is the only practical, workable way to achieve necessary changes quickly in a manner that preserves the state consumer protections we consumers demand. This state-based regulatory reform approach far exceeds having a highly-politicized "insurance czar" in Washington, D.C., along with the huge, costly, isolated federal

bureaucracy that will accompany it. This state-based reform track rewards the citizens and consumers in each state by giving us necessary control over important aspects of insurance and claims procedures that affect our and our families' financial security in the communities where we live.

The NAIC and its member states have fully cooperated over the years with important inquiries by Congress into the adequacy of the state regulatory system. We believe these inquiries have been productive, and have clearly demonstrated why local and regional state regulation of insurance is the very best way to meet the demands of consumers for this unique financial product. We will continue to work with Congress and within state government to improve the national efficiency of state insurance regulation, while at the same time preserving our longstanding proven and successful dedication to protecting American consumers.

Insurance regulatory modernization and protection of our fellow insurance consumers are not, nor should they ever be, mutually exclusive notions. We can and must achieve both these important objectives.

ATTACHMENT A

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NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

"A REINFORCED COMMITMENT: INSURANCE REGULATORY MODERNIZATION ACTION PLAN"

Update Status as of November 2003

I. Consumer Protection

An open process ... access to information and consumers' views ... our primary goal is to protect insurance consumers, which we must do proactively and aggressively, and provide improved access to a competitive and responsive insurance market.

The NAIC members will keep consumer protection as their highest priority by:

(1) Providing NAIC access to consumer representatives and having an active organized strategy for obtaining the highly valued input of consumer representatives in the proceedings of all NAIC committees, task forces, and working groups;

> **Update:** To help ensure active and organized consumer representation, the NAIC provides funding for thirteen consumer representatives to participate in NAIC activities. The NAIC also formally recognizes four un-funded consumer representatives. Finally, the NAIC's Consumer Protections Working Group provides a formal structure for consumer issues.

(2) Developing disclosure and consumer education materials, including written and visual consumer alerts, to help ensure consumers are adequately informed about the insurance market place, are able to distinguish between authorized an unauthorized insurance products marketed to them, and are knowledgeable about state laws governing those products;

> **Update:** The NAIC's Unauthorized Media Outreach Subgroup adopted the following recommendations during the NAIC Fall National Meeting:
>
> 1. The subgroup recommends the NAIC "Get Smart Week" highlight unauthorized entity operations;

2. The subgroup recommends the NAIC establish a centralized repository to facilitate the sharing of states' articles, press releases and media outreach efforts regarding unauthorized entities;

3. The subgroup recommends the completion of a Fiscal Impact Statement to pursue NAIC funding for a more detailed and on-going media outreach campaign;

4. The subgroup recommends NAIC staff survey the states to determine state restrictions regarding funding from third parties for consumer education efforts; and

5. The subgroup recommends the incorporation of educational materials regarding unauthorized entities into states' pre-licensing and continuing education requirements for producers.

The implementation of these initiatives will begin in late 2003 and continue through 2004.

(3) Providing an enhanced Consumer Information Source (CIS) as a vehicle to ensure consumers are provided access to the critical information they need to make informed insurance decisions;

Update: The CIS provides consumers with a means for obtaining complaint trends on insurance companies and file complaints with the appropriate state insurance department. The most recent enhancement to the CIS was the posting of key financial information designed to provide the average consumer with an easier way to view and understand important financial information about insurance companies. The Consumer Protections Working Group continues to monitor the CIS to ensure additional information is made available as necessary.

(4) Reviewing and assessing the adequacy of consumer remedies, including state arbitration laws and regulations, so that the appropriate forums are available for adjudication of disputes regarding interpretation of insurance policies or denials of claims; and

Update: The Consumer Protections Working Group held two public hearings in 2003 to review and assess the adequacy of state arbitration laws and regulations. The working group will make its final assessment and recommendations on this issue during the NAIC Winter National Meeting in December 2003. The Consumer Protections Working Group and the Consumer Liaison Committee will continue to serve as the appropriate forums for discussing and assessing consumer remedies.

(5) Developing and reviewing consumer protection model laws and regulations to address consumer protection concerns.

Update: The Consumer Protections Working Group oversees this effort as necessary.

II. Market Regulation

Market analysis to assess the quality of every insurer's conduct in the marketplace, uniformity, and interstate collaboration ... the goal of the market regulatory enhancements is to create a common set of standards for a uniform market regulatory oversight program that will include all states.

The NAIC has established market analysis, market conduct, and interstate collaboration as the three pillars on which the states' enhanced market regulatory system will rest. The NAIC recognizes that the marketplace is generally the best regulator of insurance-related activity. However, there are instances where the market place does not properly respond to actions that are contrary to the best interests of its participants. A strong and reasonable market regulation program will discover these situations, thereby allowing regulators to respond and act appropriately to change company behavior.

Market Analysis

While all states conduct market analysis in some form, it is imperative that each state have a formal and rigorous market analysis program that provides consistent and routine reports on general market problems and companies that may be operating outside general industry norms. To meet this goal:

(1) Each state will produce a standardized market regulatory profile for each "nationally significant" domestic company. The creation of these profiles will depend upon the collection of data by each state and each state's full participation in the NAIC's market information systems and new NAIC market analysis standards; and

Update: The Market Information Systems Working Group (MAWG) is reviewing the current data codes, reporting structure and reports available from the NAIC's market information systems. The NAIC continues to encourage full state participation in all of the market information systems (Regulatory Information Retrieval Systems, Complaint Database System, Special Activities Database and Exam Tracking System). Based upon the information contained in these databases, NAIC staff is developing automated programs that will generate standardized market regulatory profiles, which will include the following 5-year information for each company: (1) state specific premium volume written, (2) modified financial summary profile, (3) complaints index report, (4) regulatory actions report, (5) special activities report, (6) closed complaints report, (7) exam tracking systems summary, (8) modified IRIS ratios, (9) defense const against reserves information and (10) Schedule T information. While some of this information can already be generated, the ability to

generate a full report of this information should be available by March 1, 2004.

(2) Each state will adopt uniform market analysis standards and procedures and integrate market analysis with other key market regulatory functions.

Update: The NAIC is in the process of developing a Market Analysis Handbook, which is scheduled for adoption at the NAIC Winter National Meeting in December 2003. The guidelines in this handbook will provide states with uniform market analysis, standards, and procedures, which will integrate market analysis with other regulatory functions. The purpose of the market analysis handbook is to identify data and other information that is available to regulators, and provide guidance on how that data can be used to target the most significant market problems. In addition to helping identify potential problems, the handbook will help states develop a more detailed understanding of the marketplace to target their regulatory resources more efficiently. If used consistently and uniformly by the states, the handbook also should facilitate interstate collaboration by giving states a common baseline of knowledge from which to pursue collaborative actions.

The market conduct annual statement is a pilot project designed to determine whether a market conduct annual statement could serve as a market analysis tool that all states could use to review market activity of the entire insurance marketplace consistently and identify companies whose practices are outside normal ranges. If the pilot is a success, this will be a tool to help states more effectively target market regulatory efforts. By using common data and analysis, states would have a uniform method of comparing companies' performance not only within their respective states, but also across the various states, thus providing enhanced opportunities for coordinating market regulatory efforts. This increased analysis, targeting, and coordination should result in fewer duplicative regulatory efforts. As the statement develops, states should be able to reduce the number of state-specific data calls and collect data about claims, non-renewals and cancellations, replacement-related activity and complaints on an industry-wide basis.

In the pilot, information is being collected for personal lines, life and annuity products. If a company's performance appears to be unusual as compared to the industry, states will undertake further review of that company. The additional review may range from calling the company for further information to pursuing further analysis or conducting an examination.

In 2002, nine pilot states (CA, IL, MD, MO, NE, OH, OR, PA and WI) began collecting data from life insurers. The life data has now been

received and analyzed. Based upon this analysis, specific companies have been identified for additional scrutiny and an appropriate regulatory response.

The pilot states also are working with P&C insurers. P&C insurers were required to submit data for the period from January 1, 2003 through June 30, 2003 by September 1, 2003. Assuming there are no data quality issues, the pilot states will complete their analysis of the data by November 2003. During the NAIC 2003 Winter National Meeting in December 2003, the pilot states will discuss their results for the property and casualty industry, identify common companies of concern and propose coordinated responses where appropriate.

Market Conduct

States will also implement uniform market conduct examination procedures that leverage the use of automated examination techniques and uniform data calls; and

(1) States will implement uniform training and certification standards for all market regulatory personnel, especially market analysts and market conduct examiners; and

Update: The NAIC currently offers training on the Market Conduct Examiners Handbook. In 2004, the NAIC will offer a new program addressing market analysis techniques. Additional detail regarding uniform training and certification standards will be developed in 2004.

(2) The NAIC's Market Analysis Working Group will provide the expertise and guidance to ensure the viability of uniform market regulatory oversight while preserving local control over matters that directly affect consumers within each state.

Update: The Market Analysis Working Group (MAWG) is already a functioning group with draft protocols to be followed for the coordination and collaboration of market regulatory intervention. These protocols will be further refined in 2003 and should be finalized in early 2004. MAWG is analogous to the NAIC's Financial Analysis Working Group, and will continue to serve as the focal point for the coordination of market regulatory efforts while preserving local control for matters that directly affect consumers within each state.

Interstate Collaboration

The implementation of uniform standards and enhanced training and qualifications for market regulatory staff will create a regulatory system in which states have the confidence to rely on each other's regulatory efforts. This reliance will create a market regulatory system of greater domestic deference, thus allowing individual states to

concentrate their market regulatory efforts on issues that are unique to their individual market place conditions.

> **Update:** To help minimize variations in market conduct examinations so that states can rely on each other's findings, the NAIC adopted the *Market Conduct Uniform Examination Outline*. This outline, which was developed in 2002, focuses on the following four areas: (1) exam scheduling, (2) pre-exam planning, (3) core examination procedures and (4) exam reports. Forty of the fifty-five jurisdictions self-certified compliance with two of the four uniform examination areas in 2002. Thirty-two states have self certified compliance with all four uniform examination areas in 2003. The goal for 2003 is to have at least 40 states certify compliance with all four areas of exam uniformity and develop a process for resolving complaints about certifications.

(1) Each state will monitor its "nationally significant" domestic companies on an on-going basis, including market analysis and appropriate follow up to address any identified problems;

> **Update:** As discussed above, company profile templates are being developed to provide a baseline for monitoring company activity. The Market Analysis Handbook contains a spectrum of regulatory responses that might be initiated. For example, the handbook identifies responses that could range from consumer outreach and education to a desk audit to an on-site examination.

(2) Market conduct examinations of "nationally significant" companies performed by a non-domestic state will be eliminated unless there is a specific reason that requires a targeted market conduct examination; and

> **Update:** States are moving toward targeted examinations and coordinating their efforts through MAWG.

(3) The Market Analysis Working Group will assist states to identify market activities that have a national impact and provide guidance to ensure that appropriate regulatory action is being taken against insurance companies and producers and that general market issues are being adequately addressed. This peer review process will become a fundamental and essential part of the NAIC's market regulatory system.

> **Update:** To help facilitate the coordination of regulatory efforts, the NAIC's Exam Tracking System (ETS) was enhanced in 2002 to make the reporting and sharing of market conduct examination information easier. As of March 2003, 26 states had entered examination information for over 400 companies into ETS. The NAIC has been analyzing this information to identify multiple exam notifications for the same companies. At the 2003 NAIC Summer National Meeting, the NAIC staff provided a list of

companies with multiple examinations scheduled, and the states shared their respective exam plans and concerns about the identified companies. Where overlap was noted, a lead state was designated to coordinate efforts. Since then, regulators have continued to discuss common concerns and coordinate their efforts. With increased use of ETS and regular opportunities for states to share information, improved coordination of exam efforts is well underway.

Forty states are currently participating or have participated in at least one new collaborative market conduct examination during 2003. Based upon these efforts, the NAIC's Market Analysis Working Group is now developing formalized guidelines and protocols for collaborating on regulatory efforts.

III. "Speed-to-Market" for Insurance Products

Interstate collaboration and filing operational efficiency reforms ... state insurance commissioners will continue to improve the timeliness and quality of the reviews given to insurers' filings of insurance products and their corresponding advertising and rating systems.

Insurance regulators have embarked on an ambitious 'Speed-to-Market Initiative' which covers the following four main areas:

(1) Integration of multi-state regulatory procedures with individual state regulatory requirements;

(2) Encouraging states to adopt regulatory environments that place greater reliance on competition for commercial lines insurance products;

(3) Full availability of a proactively evolving System for Electronic Rate and Form Filing (known as 'SERFF') that includes integration with operational efficiencies (best practices) developed for the achievement of speed-to-market goals; and

(4) Development and implementation of an interstate compact to develop uniform national product standards and provide a central point of filing.

Update: To demonstrate that states are up to the challenge of providing speed to market for insurance products without sacrificing adequate consumer protection, a system of measurement is needed. NAIC has developed a set of uniform metrics that rely on the four operational efficiencies listed above. To date approximately 20 jurisdictions have reported preliminary information to the NAIC. The Action Plan establishes a goal of 2008 for universal use; however, those working on the project believe most jurisdictions will implement filing metrics long

before that date. It should be noted that SERFF has the necessary counting and reporting framework for both paper and electronic product filings.

Integration of Multi-state Regulatory Procedures

It is the goal that all state insurance departments will be using the following regulatory tools by December 31, 2008:

(1) Review standards checklists for insurance companies to verify the filing requirements of a state before making a rate or policy form filing;

Update: The review standards checklists provide a means for insurance companies to verify the filing requirements of a state before making a rate or policy form filing. The checklists contain information regarding specific state statutes, regulations, bulletins or case law that pertain to insurance issues. Currently, 45 states have developed and posted Review Standards Checklists to their state websites. All insurers may access the information for all states via the NAIC web site.

States report that insurers taking advantage of this regulatory modernization have found the likelihood for successfully submitting a filing increases dramatically, vastly improving speed to market for insurers. The remaining states expect to complete their checklists and have them on-line by June 2004.

(2) Product requirements locator tool, which is already in use, will be available to assist insurers to locate the necessary requirements of the various states to use when developing their insurance products or programs for one or multiple-state markets;

Update: The product requirements locator tool is available to assist insurers in locating the necessary requirements of various states which must be used when developing insurance products for one or more states. This program allows someone to query a searchable NAIC database by product (i.e. auto insurance), requirement (i.e. cancellation statute), or state to determine what is needed to develop an insurance product or make a filing in one specific state or many states, for one type of insurance or for many types of insurance. Sixteen states have populated the property and casualty product requirements locator tool as of October 2003. The life product requirements locator tool is under development. The Action Plan establishes a goal of 2008 for universal use; however, those working on the project believe most jurisdictions will implement this long before that date.

(3) Uniform product coding matrices, already developed, will allow uniform product coding so that insurers across the country can code their policy filings using a set of universal codes without regard for where the filing is made; and

Update: Product coding matrices have been developed to provide a uniform product naming convention and corresponding product coding, so that insurers across the country can seamlessly communicate with insurance regulators regarding product filings. This key feature forms the basis for counting and measuring speed to market for insurance products. A survey is underway to determine how many states are using these tools. The Action Plan establishes a goal of 2008 for universal use. However, those working on the project believe most jurisdictions will implement this long before that date.

(4) Uniform transmittal documents to facilitate the submission of insurance products for regulatory review. The uniform transmittal document contains information that is necessary to track the filing through the review process and other necessary information. The goal is that all states adopt it for use on all filings and databases related to filings by December 31, 2003.

Update: Uniform transmittal documents were developed to permit uniform product coding, so that insurers across the country can code their policy filings using a set of universal codes without regard for where the filing is made. Instead of using the numerous codes developed historically by each individual state for its own lines of insurance, a set of common codes have been developed, using the annual statement blanks as a guideline, in an effort to eliminate the need for insurance companies to keep separate lists of codes for each state insurance department's lines of insurance. A survey is underway to determine the extent of their use. The Action Plan establishes a goal of 2008 for universal use; however, those working on the project believe most jurisdictions will implement this long before that date.

Adoption of Regulatory Frameworks that Place Greater Reliance on Competition

States will continue to ensure that the rates charged for products are actuarially sound and are not excessive, inadequate or unfairly discriminatory. To the extent feasible, for most markets, states recognize that competition can be an effective element of regulation. While recognizing that state regulation is best for insurance consumers, it also recognizes that state regulation must evolve as insurance markets change.

Update: The NAIC has adopted a model law that places greater reliance on competition for commercial lines insurance products. It is actively encouraging states to consider it; however, hard market conditions in the property and casualty insurance markets in many states make it difficult for state legislators to support a relaxing of rate regulatory requirements in a time when prices are dramatically rising for businesses seeking coverage.

Full availability of a proactively evolving System for Electronic Rate and Form Filing (SERFF)

SERFF is a one-stop, single point of electronic filing system for insurance products. It is the goal of state insurance departments to be able to receive product filings through SERFF for all major lines and product types by December 2003. We will integrate all operational efficiencies and tools with the SERFF application in a manner consistent with our Speed-to-Market Initiatives and the recommendations of the NAIC's automation committee.

> **Update:** SERFF is the ultimate answer to speed to market concerns of insurers. All 50 states, the District of Columbia, and Puerto Rico are SERFF ready. Insurers that have chosen to use SERFF are experiencing an average 17-day turn-around time for the entire filing submission and review cycle. SERFF offers functionality that can enable all regulatory jurisdictions to accept electronic rate and form filings from insurance companies for all lines of insurance and product types. There are 50 states accepting filings for the property/casualty line of business, 42 of which are accepting all major lines. There are 48 states accepting life filings, 39 of which are accepting all major lines, and 41 states are currently accepting health filings via SERFF, 34 of which are accepting all major lines. SERFF enables states to include all operational efficiency tools such as the review standards checklists, requirements included in the product requirements locator, and uniform transmittal documents to facilitate an efficient electronic filing process. There are over 950 insurance companies licensed to use SERFF and over 55,000 filing have been submitted via SERFF thus far in 2003. Estimates suggest that 75,000 filings are expected this year with between 125,000 and 150,000 expected in 2004. The NAIC has estimated that the total universe of filings is approximately 750,000 total filings in an average year.

Implementation of an Interstate Compact

Many products sold by life insurers have evolved to become investment-like products. Consequently, insurers increasingly face direct competition from products offered by depository institutions and securities firms. Because these competitors are able to sell their products nationally, often without any prior regulatory review, they are able to bring new products to market more quickly and without the expense of meeting different state requirements. Since policyholders may hold life insurance policies for many years, the increasing mobility in society means that states have many consumers who have purchased policies in other states. This reality raises questions about the logic of having different regulatory standards among the states.

The Interstate Insurance Product Regulation Compact will establish a mechanism for developing uniform national product standards for life insurance, annuities, disability income insurance, and long-term care insurance products. It will also create a single point

to file products for regulatory review and approval. In the event of approval, an insurer would then be able to sell its products in multiple states without separate filings in each state. This will help form the basis for greater regulatory efficiencies while allowing state insurance regulators to continue providing a high degree of consumer protection for the insurance buying public.

State insurance regulators will work with state law and policymakers with the intent of having the Compact operational in at least 30 states or states representing 60% of the premium volume for life insurance, annuities, disability income insurance and long-term care insurance products entered into the Compact by year-end 2008.

Update: The NAIC adopted draft model legislation for the Interstate Insurance Product Regulation Compact (the "Compact") in December 2002. Working with the National Conference of State Legislatures (NCSL) and the National Conference of Insurance Legislators (NCOIL), as well as the American Council of Life Insurers (ACLI), the NAIC adopted technical amendments to the model legislation in July 2003. The NCSL and NCOIL have now endorsed the Compact.

In early 2003, the model legislation was introduced in three states, Alabama, Indiana and Iowa. Iowa became the first state to enact the Compact. It is anticipated that legislation to enact the Compact will be introduced in 10 to 15 states during their next legislative sessions.

As part of the effort of state insurance regulators to develop national product standards for life insurance, annuity, disability income insurance, and long-term care insurance products, the NAIC has created the Interstate Compact National Standards Working Group. The primary goal of this working group is to begin developing high-quality national product standards while the Compact is being implemented in the states. Not only will the product standards developed by this working group serve as a foundation for those standards developed through the Compact, they will also serve as an example to all that strong consumer protections will be the highest priority under the Compact.

Just prior to the NAIC's Fall National Meeting in September, the working group released for comment two sets of draft product standards covering term life insurance and variable annuities. It is anticipated that final adoption of these draft standards will occur either at the NAIC's Winter National Meeting or shortly thereafter. Additionally, the NAIC is beginning to work on draft bylaws and operating procedures for the Compact.

IV. Producer Licensing Requirements

Uniformity of forms and process ... the NAIC's broad, long-term goal is the implementation of a uniform, electronic licensing system for individuals and business entities that sell, solicit or negotiate insurance.

The states have satisfied GLBA's licensing reciprocity mandates and continue to view licensing reciprocity as an interim step. Our goal is uniformity.

Building upon the regulatory framework established by the NAIC in December of 2002, the NAIC's members will continue the implementation of a uniform, electronic licensing system for individuals and business entities that sell, solicit or negotiate insurance. While preserving necessary consumer protections, the members of the NAIC will achieve this goal by focusing on the following five initiatives:

(1) Development of a single uniform application;

Update: The Producer Licensing Working Group adopted uniform individual and business entity applications to be used for both resident and non-resident licensing. The full NAIC membership will consider the adoption of these applications during the NAIC Winter National Meeting in December 2003.

(2) Implementation of a process whereby applicants and producers are required to satisfy only their home state pre-licensing education and continuing education (CE) requirements;

Update: This system of CE reciprocity is already established and working. The NAIC continues to monitor this system to ensure CE reciprocity remains in place.

(3) Consolidation of all limited lines licenses into either the core limited lines or the major lines;

Update: The NAIC has adopted definitions for the following core limited lines, and has included these limited lines as part of the uniform applications: Car Rental, Credit, Crop, Travel and Surety. States are now in the process of consolidating all their limited lines into these core categories. This process will continue through the 2004 state legislative sessions.

(4) Full implementation of an electronic filing/appointment system; and

Update: Thirty-eight states and the District of Columbia have implemented an electronic filing/appointment system. Six states do not require appointments. The NAIC and its affiliate, the National Insurance

Producer Registry, continue to work with the remaining states to implement an electronic filing/appointment system.

(5) Implementation of an electronic fingerprint system. In accomplishing these goals, the NAIC recognizes the important and timely role that state and federal legislatures must play in enacting necessary legislation.

Update: The NAIC developed a draft Authorization for Criminal History Record Check Model Act, and continues to have informal discussions about access to the FBI with representatives of the FBI. While states are currently able to obtain access to the FBI database through the adoption of proper legislative authority, Federal law prohibits states from sharing criminal history record information with each other. The NAIC continues to seek solutions to resolve the prohibition against the sharing of information.

National Insurance Producer Registry (NIPR)

Through the efforts of NIPR, major steps have been taken to streamline the process of licensing non-residents and appointing producers, including the implementation of programs that allow electronic appointments and terminations. Other NIPR developments helping to facilitate the producer licensing and appointment process include:

Update: There are 25 states and the District of Columbia accepting electronic non-resident licensing applications through NIPR with the goal of 35 by December 31, 2003, and 32 states is a very realistic estimate at this time.

(1) Use of a National Producer Number, which is designed to eliminate sole dependence on using social security numbers as a unique identifier;

Update: There are 15 states currently using the NPN as the unique identifier on the database, with a goal of 27 states having NPN implemented by December 31, 2003.

(2) Acceptance of electronic appointments and terminations or registrations from insurers;

Update: There are 38 states and the District of Columbia accepting electronic appointments and terminations through NIPR's Gateway. Six states do not require appointments. The goal is to achieve 50 states by December 31, 2003.

(3) Use of Electronic Funds Transfer for payment of fees. The goal is to have full state implementation of the services provided by NIPR by December of 2006.

Update: There are seven states using Electronic Funds Transfer for payment of fees, with a goal of 13 by December 31, 2003.

V. Insurance Company Licensing

Standardized filing and baseline review procedures...the NAIC will continue to work to make the insurance company licensing process for expanding licensure as uniform as appropriate to support a competitive insurance market.

Except under certain limited circumstances, insurance companies must obtain a license from each state in which they plan to conduct business. In considering licensure, state regulators typically assess the fitness and competency of owners, boards of directors, and executive management, in addition to the business plan, capitalization, lines of business, market conduct, etc. The filing requirements for licensure vary from state to state, and companies wishing to be licensed in a number of states have to determine and comply with each state's requirements. In the past three years, the NAIC has developed, and all states have agreed to participate in, a Uniform Certificate of Authority Application process that provides significant standardization to the filing requirements that non-domestic states use in considering the licensure of an insurance company.

Update: Presently, all 50 states and the District of Columbia accept the NAIC's Uniform Certificate of Authority Application (UCAA) from insurers desiring to do business their state. The UCAA has been under development for sometime and work continues to eliminate a few remaining state specific application filing requirements. However, many of these additional requirements come from state statute or regulation in a small number of states.

In its commitment to upgrade and improve the state-based system of insurance regulation in the area of company licensing, the NAIC will:

(1) Maximize the use of technology and pre-population of data needed for the review of application filings;

Update: Internal NAIC staff meetings are underway to re-write much of the existing computer system. The goal of the re-write is to create a more automated, user-friendly system for companies. In this regard, the NAIC Financial Data Repository holds a significant amount of data/information that insurers include on the UCAA. By pre-populating much of the UCAA, the time and effort for making an application should be dramatically reduced. Furthermore, re-programming will occur to streamline the data/information inputs required. As noted, planning and design work is underway this quarter. We expect that much of the work to achieve these goals will be accomplished by the second quarter of 2004.

(2) Develop a Company Licensing Model Act to establish standardized filing requirements for a license application and to establish uniform licensing standards; and

> **Update:** The NAIC is undertaking this work to further unify the states. As noted above, there are some additional filing requirements to the UCAA in certain states. By creating an NAIC model and pushing states to adopt it, absolute uniformity can be achieved. In addition, through such a model, states will be more uniform in their standards for issuing or denying a certificate of authority. This will add transparency and more certainty to the company licensing process. This work will likely be initiated in the second quarter of 2004, once substantial progress is made in developing baseline and best practices for reviewing UCAA's. The Regulatory Modernization Action Plan calls for such a model to be ready by December 2004.

(3) Develop baseline licensing review procedures that ensure a fair and consistent approach to admitting insurers to the marketplace and that provide for appropriate reliance on the work performed by the domestic state in licensing and subsequently monitoring an insurer's business activity.

> **Update:** The NAIC is planning to initiate this work early next year. It is expected that this element of the initiative will indirectly support the work outlined regarding a model act. This area is likely to be the most labor intensive as we are looking to "break new ground". While this work will proceed before work on a model act, we expect that by May 2004 the two efforts will converge.

As company licensing is adjunct to a solvency assessment, the members of the NAIC will consider expanding the Financial Regulation and Accreditation Standards Program to incorporate the licensing and review requirements as appropriate. This action will assure appropriate uniformity in company licensing and facilitate reciprocity among the states. As much of this work is well underway, the NAIC will implement the technology and uniform review initiatives, and draft the model act by December 2004.

> **Update:** Once the work identified has been completed and the NAIC sees states conforming, the model and associated review procedures and licensing standards will be presented to the Financial Regulation Standards and Accreditation (F) Committee for consideration.

VI. Solvency Regulation

Deference to lead states ... state insurance regulators have recognized a need to more fully coordinate their regulatory efforts to share information proactively, maximize technological tools, and realize efficiencies in the conduct of solvency monitoring

Deference to "Lead States"

Relying on the concept of "lead state" and recognizing insurance companies by group, when appropriate, the NAIC will implement procedures for the relevant domestic states of affiliated insurers to plan, conduct and report on each insurer's financial condition.

> **Update:** Two years ago, the NAIC developed a comprehensive guidance paper on insurance holding company oversight. In conjunction with this effort, the NAIC developed a "lead state" framework under which a state or states were designated as "lead" for various group solvency oversight work (e.g., financial analysis, examinations, holding company filings/transactions etc). This framework is still in its development stages, but significantly more state coordination on solvency oversight has occurred since its creation. Through NAIC financial processes, as well as at the state level, this framework continues to be used to help ensure effective and efficient financial regulation.

Financial Examinations

In regard to financial examinations, many insurers are members of a group or holding company system that has multiple insurers and that may have multiple states of domicile. These affiliated insurers often share common management along with claims, policy and accounting systems, and participate in the same reinsurance arrangements. Requirements for coordination of financial examinations will be set forth in the NAIC *Financial Condition Examiners Handbook.* To allow time for the states to adjust examination schedules and resources, such coordination will be phased in over the next 5 years, with the goal of full adherence to the Handbook's guidance for examinations conducted as of December 2008.

> **Update:** This initiative aims to institutionalize the lead state framework and move boldly toward syncing on-site examinations of affiliated insurers. Much discussion on the effectiveness and efficiency of financial examinations has occurred during the past 2 years. Therefore, regulators working through the NAIC are well prepared to move forward with designing and implementing the requisite language in the NAIC Financial Condition Examiners Handbook. As this Handbook is an NAIC Accreditation Standard, the Financial Regulation Standards and Accreditation (F) Committee will consider these amendments in due course, which should occur by March 2005.

Insolvency Model Act

The NAIC will promote uniformity by reviewing the Insolvency Model Act, maximizing use of technology, and developing procedures for state coordination

of imminent insolvencies and guaranty fund coverage. The Financial Regulation Standards and Accreditation Committee will consider the requirements no later than January 1, 2008.

Update: The Insurer Receivership Model Act (IRMA) is the primary model act involved, since receivership often should be obtained while insurers are in hazardous financial condition before they become insolvent. Every state has adopted a version of an NAIC model act dealing with insurer receiverships, but many of these are based on versions from the 1930's (NAIC's version of a draft of the Uniform Insurers Liquidation Act in 1936) and the 1960-70's (NAIC Insurers Rehabilitation and Liquidation Model Act). The NAIC has been reviewing the IRMA to incorporate parts of the Uniform Receivership Law (URL) issued by the Interstate Insurance Receivership Compact Commission in 1998. Currently, the NAIC is finalizing the process of incorporating parts of the URL, and is also incorporating updates related to other recent issues. This review aims to ensure that IRMA reflects the current best practices for conducting statutory receiverships of insurers, and is an updated model that can be adopted in substantially similar form by all of the states. The current NAIC Accreditation Standard is that states must have a scheme for handling receiverships. The Financial Regulation Standards and Accreditation (F) Committee will consider an amendment to require enactments substantially similar to the IRMA in due course, which should occur by March 2006.

In regard to maximizing the use of technology, the NAIC has begun developing a Global Receivership Information Database (GRID) to better capture, analyze, and report information on insurer receiverships and the causes of hazardous financial condition and insolvency. The system should be in place in 2004. The NAIC will consider making the entry of data into the system a requirement for the Uniform Regulation Through Technology designation. Information captured by the GRID should provide measurements of receivership procedures that can be used to improve them.

In regard to developing procedures for state coordination of imminent insolvencies and guaranty fund coverage, the NAIC has begun drafting procedures for coordinating with state guaranty associations. Once work on the procedures has been completed and the NAIC sees states conforming, the procedures will be presented to the Financial Regulation Standards and Accreditation (F) Committee for consideration.

VII. Changes of Insurance Company's Control

Streamline the process for approval of mergers and other changes of control.

Coordination Using "Lead States"

Regulatory consideration of the acquisition of control or merger of a domestic insurer is an important process for guarding the solvency of insurers and protecting current and future policyholders. At the same time, NAIC members realize that these transactions are time sensitive and the process can be daunting when approvals must be obtained in multiple states. As a result, states will enhance their coordination and communication on acquisitions or mergers of insurers domiciled in multiple states by designing a system through which these multi-state reviews are coordinated by one or more "lead" states.

> **Update:** As noted above (Section VI), regulators are in process of implementing the NAIC lead state framework.

Form A Database

Insurers are required to file for approval on documents referred to as Form A filings when mergers or acquisitions are being considered. The NAIC has created a database to track these filings so that this information is available to all state regulators. Usage will be monitored to ensure that all states use the application to improve coordination of Form A reviews and to alert state regulators to problem filings. The Form A Review Guide and Form A Review Checklist, which contain procedures to be utilized when reviewing a Form A Filing, will be enhanced and incorporated into the existing NAIC *Financial Analysis Handbook* as a supplement. NAIC members will work on amending the Accreditation Program to include the Form A requirements to further promote stronger solvency standards and state coordination, as well as an efficient process for our insurers. The Form A requirements will be targeted for incorporation into the Accreditation Program no later than January 1, 2007.

> **Update:** The NAIC's Form A Database, initially released in March 2002, was designed to alert states to Form A filings from the same or similar individuals or entities in other states. Efforts continue to educate and inform regulators on the use and benefits of this database system to the regulatory community. The benefits occur largely in the area of coordinating on common Form A filings and identifying acquiring parties who are suspicious.
>
> Along with the NAIC's guidance paper on insurance holding companies, formal review programs were designed for the various holding company disclosures and registration filings, including Form A's. Beginning in December 2003, the Insurance Holding Company Working Group will revisit these forms for the purpose of developing a comprehensive program on Form A filings. The working group will focus initially on how to bring about more consistent communication on multi-state Form A filings. This program should be completed by the fall of 2004.

Integrate Policy Form Approval and Producer Licensing into the Merger and Acquisition Process

The NAIC members will develop procedures for the seamless transfer of policy form approvals and producer appointments to take place contemporaneously with the approval of mergers or acquisitions where appropriate. We will begin developing and testing these procedures through pilot programs in 2003 and fully incorporate them system wide by 2006.

> **Update:** With regard to the integration of policy form approval and producer licensing into the M&A process, two pilot projects are underway to study how these two regulatory process are commonly handled by states. As this work is new, we expect much of 2004 will be needed to complete the research and to begin formulating an implementation plan.

* * *

ATTACHMENT B

Joint Resolution

STATES AS THE SOLE REGULATORS OF THE BUSINESS OF INSURANCE

WHEREAS, protecting consumers and ensuring the safety and soundness of insurance companies operating in the United States have been the prime objectives of state insurance regulation for over 150 years; and

WHEREAS, the states have the sole authority to regulate the business of insurance as provided under the McCarran-Ferguson Act and as recently affirmed by the Gramm-Leach-Bliley Financial Services Modernization Act of 1999; and

WHEREAS, state insurance regulation has been successful and effective, and has continuously adapted to change in the marketplace including but not limited to the challenges of financial services modernization; and

WHEREAS, in responding to the Gramm-Leach-Bliley Financial Services Modernization Act, states already have successfully implemented reforms to meet the requirements of the law including, among other things, agent licensing reform and consumer financial privacy protections, and are working to develop and implement further efficiencies; and

WHEREAS, governors, state legislators, and insurance commissioners have acknowledged the need to streamline and simplify insurance regulation for the 21st century financial services marketplace and are enacting specific reforms to address differences in state laws and rules that can present obstacles to insurers, consumers' needs, and market place efficiencies; and

WHEREAS, some insurance companies and national associations representing insurers and banks support federal legislation to either establish one federal regulator of insurance or allow for dual federal and state insurance regulation; and

WHEREAS, if enacted by Congress, these proposals will bifurcate insurance regulation between the states and the federal government, undermining the state system of consumer protections and financial surveillance, as well as inevitably causing a loss of jobs, taxes, fees, and other vital and necessary state revenues needed to effectively regulate the insurance market and provide revenues to support residual market programs, such as high-risk pools.

NOW, THEREFORE BE IT RESOLVED, THAT the National Conference of State Legislatures (NCSL), the National Conference of Insurance Legislators (NCOIL), and the National Association of Insurance Commissioners (NAIC) are committed to maintaining the States as the sole regulators of the business of insurance, and continue to support state efforts to streamline, simplify and modernize insurance regulation; and

BE IT FURTHER RESOLVED, THAT the National Conference of State Legislatures (NCSL), the National Conference of Insurance Legislators (NCOIL), and the National Association of Insurance Commissioners (NAIC) will oppose any proposed Federal law that undermines this state authority, including allowing insurers the ability to obtain federal charters, or ceding any authority to federal agencies to regulate financial institutions involved in the business of insurance.

BE IT FURTHER RESOLVED, THAT a copy of this resolution shall be sent to the President of the United States, the Secretary of the Treasury, and all members of the United States Senate and the United State House of Representatives.

State Representative Kathleen Keenan, Vermont
President, National Conference of Insurance Legislators

State Representative Donna Stone, Delaware
Chair, Standing Committee on Financial Services
National Conference of State Legislatures

Mike Pickens, Commissioner of Insurance, Arkansas
President, National Association of Insurance Commissioners

THE COUNCIL OF STATE GOVERNMENTS

CSG GOVERNING BOARD/EXECUTIVE COMMITTEE

RESOLUTION ON
STATES AS THE SOLE REGULATORS
OF THE BUSINESS OF INSURANCE

WHEREAS, protecting consumers and ensuring the safety and soundness of insurance companies operating in the United States have been the prime objectives of state insurance regulation for over 150 years; and

WHEREAS, the states have the sole authority to regulate the business of insurance as provided under the McCarran-Ferguson Act and as recently affirmed by the Gramm-Leach-Bliley Financial Services Modernization Act of 1999; and

WHEREAS, state insurance regulation has been successful and effective, and has continuously adapted to change in the marketplace including but not limited to the challenges of financial services modernization; and

WHEREAS, in responding to the Gramm-Leach-Bliley Financial Services Modernization Act, states already have successfully implemented reforms to meet the requirements of the law including, among other things, agent licensing reform and consumer financial privacy protections, and are working to develop and implement further efficiencies; and

WHEREAS, governors, state legislators, and insurance commissioners have acknowledged the need to streamline and simplify insurance regulation for the 21st century financial services marketplace and are enacting specific reforms to address differences in state laws and rules that can present obstacles to insurers, consumers' needs, and market place efficiencies; and

WHEREAS, some insurance companies and national associations representing insurers and banks support federal legislation to either establish one federal regulator of insurance or allow for dual federal and state insurance regulation; and

WHEREAS, if enacted by Congress, these proposals will bifurcate insurance regulation between the states and the federal government, undermining the state system of consumer protections and financial surveillance, as well as inevitably causing a loss of jobs, taxes, fees, and other vital and necessary state revenues needed to effectively regulate the insurance market and provide revenues to support residual market programs, such as high-risk pools.

NOW, THEREFORE BE IT RESOLVED, THAT the Council of State Governments is committed to maintaining the States as the sole regulators of the business of insurance, and continue to support state efforts to streamline, simplify and modernize insurance regulation; and

BE IT FURTHER RESOLVED, THAT the Council of State Governments will oppose any proposed Federal law that undermines this state authority, including allowing insurers the ability to obtain federal charters, or ceding any authority to federal agencies to regulate financial institutions involved in the business of insurance.

BE IT FURTHER RESOLVED, THAT a copy of this resolution shall be sent to the President of the United States, the Secretary of the Treasury, and all members of the United States Senate and the United State House of Representatives.

Adopted this 26th Day of October, 2003, at the
CSG Annual State Trends and Leadership Forum
In Pittsburgh, Pennsylvania

Governor Mike Huckabee 2003 CSG President	Representative Daniel Bosley 2003 CSG Chair

STATEMENT OF RONNIE TUBERTINI, PRESIDENT AND CEO OF SOUTHGROUP INSURANCE AND FINANCIAL SERVICES

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

November 5, 2003

STATEMENT OF RONNIE TUBERTINI, PRESIDENT AND CEO OF SOUTHGROUP INSURANCE AND FINANCIAL SERVICES

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

November 5, 2003

Good afternoon Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is Ronnie Tubertini, and I am pleased to have the opportunity to give you my views on the current state of insurance regulation and on the role Congress can play to reform and improve our regulatory system. I am President and CEO of SouthGroup Insurance and Financial Services, Mississippi's largest privately owned insurance agency. SouthGroup Insurance and Financial Services is a Jackson-based insurance agency employing 120 people in 17 locations across the state. Although based in Mississippi, SouthGroup writes business in over 20 states and provides foreign coverage for clients operating outside of the United States. My agency represents over 50 insurance companies.

I. Introduction

At the outset, Chairman Baker, I must applaud the Subcommittee and full Committee's continued interest in these important issues as we have many challenges facing the state-based system of insurance regulation. As you have heard in previous hearings, and as I will testify today, the need for meaningful reform has increased dramatically in recent years. The enactment of financial services modernization legislation, the convergence of the financial services marketplace, the global nature of the insurance industry, and the emergence of electronic commerce are among the catalysts that have led many observers to reconsider the manner in which states regulate the business of insurance. The desire for reform has become so pressing that some segments of the industry have actually expressed support for federal regulation of our business. Proponents of such proposals argue that federal insurance regulation will promote greater uniformity, reduce costs, and cause less frustration than the current multi-state system. Other segments of the industry, including the NAIC, continue to push for reforms of state regulation in state capitals across the country and make the case that federal regulation is both dangerous and unnecessary.

In my testimony today, I will outline some of the problems and challenges that my agency faces. I will also provide the Subcommittee with my thoughts concerning the NAIC's recently unveiled action plan and my personal observations regarding the concept of federal insurance regulation. Finally, I will close with an outline of what I believe is the most effective manner in which to obtain regulatory reform of our industry in a timely fashion.

II. Challenges Facing Insurance Agents and Brokers

Like the vast majority of insurance agents and brokers, I provide insurance services to consumers, households, and business in multiple states, and my personal experiences with the existing regulatory system lead me to believe that insurance regulation must be reformed and modernized. Let me focus on two issues in particular – agent/broker licensing and product regulation.

The most significant burden facing my agency and my employees is compliance with the licensing requirements of the 20 states in which we operate. Insurance producers of all kinds – whether operating in large commercial centers or small communities – face unnecessary bureaucratic hurdles that are imposed by distinct and often idiosyncratic licensing laws. Although most states have now enacted licensing reform statutes that provide reciprocity to licensed agents and brokers, various burdens and difficulties remain. Several of the larger states still have not enacted licensing reciprocity, and many of the states that did pass licensing reform deviated from the NAIC's model law. The resulting lack of uniformity and consistency among the states makes compliance a challenge, and states still differ dramatically in the manner in which they handle nonresident licensing and renewals.

My agency is also incorporated, and our corporate status creates special hurdles and delays for us when we seek licenses in other states. While some jurisdictions simply require us to (1) prove that we are licensed and in good standing in Mississippi, (2) complete the NAIC's uniform application, and (3) submit the appropriate fee, other states impose additional requirements. In some states, for example, we are also required to complete the lengthy and expensive process of registering our agency as a foreign corporation. While we have found that state insurance departments are increasingly responsive and timely in their processing of applications, state secretaries of state are often much slower to act.

An additional bureaucratic challenge is the requirement imposed by some states that requires my agency and our producers to obtain letters of certification from the Mississippi Department of Insurance in order to obtain a nonresident license. This requirement is especially peculiar to me in light of the development of the Producer Database (PDB), the nationwide repository of agent and broker licensing information that is maintained by the National Insurance Producer Registry (NIPR). Within seconds, the PDB can provide an insurance regulator with real-time information about a person's licensing status, yet many states require me to obtain a paper letter of certification to show that I am licensed and in good standing. In my view, many states and regulators are not taking full advantage of the PDB's ability to provide quick and up-to-the-minute information about a particular agent or agency, and it is my hope that states will eliminate the letter of certification requirement. Some states have already taken this step, which has made

the licensing process more efficient, but others have taken the unappealing step of requiring the agency to obtain a copy of the PDB printout and provide it to the department.

I have also witnessed the inefficiencies and market problems that can arise because of the structural and procedural flaws associated with the regulation of insurance products. Many states regulate the development and introduction of new products into the marketplace in ways that cause significant and unnecessary delays, undermine the forces of competition, and create affordability and availability problems for consumers. This Subcommittee has previously held hearings about the problems associated with product regulation, and I thank you for spotlighting these issues. Based on my experiences, I can assure you that consumers are among those penalized because the system is not as competitive and responsive as it should be.

Some states have begun to make improvements. For example, Louisiana, Mississippi's neighbor to the west and south, recently enacted a flex-rating system that allows personal lines insurers to raise or decrease rates up to 10% per year without securing the prior approval of the state's rating commission. A similar law has had great success in South Carolina, and I am hopeful that other states will enact market-oriented statutes that revise the structural foundation of how products are regulated. States also need to make procedural reforms as well, yet some states still appear to be operating under unwritten rules and practices (e.g. rules that limit the number of filings that an insurer may submit or limit the amount of rate increase that a company may seek).

III. NAIC's Reform Efforts and the NAIC Action Plan

The NAIC has been the focal point of many of the reform efforts that have been undertaken in recent years, and I commend NAIC President Mike Pickens and Vice President Ernie Csiszar for their attention and focus on these important issues. The NAIC's reform initiatives were launched in the wake of the enactment of the Gramm-Leach-Bliley, and that organization's *Statement of Intent* provided a blueprint for their activities over the last 3½ years. In September of this year, the commissioners adopted a new outline for action, entitled *A Reinforced Commitment: Insurance Regulatory Modernization Action Plan.* I have been asked by the Subcommittee to provide my thoughts on this latest plan, and I have done so below.

My reaction to the updated action plan is mixed. On one hand, as a strong supporter of state insurance regulation, I am pleased that the NAIC is "renewing [its] commitment to modernizing the state-based system of insurance regulation" and outlining specific objectives for the coming months and years. Many of the NAIC's stated goals are critically important, and I welcome their inclusion in the document. On the other hand, I am somewhat disappointed that the action excludes other potential steps and establishes certain timeframes that are more than five years away. Earlier drafts of the action plan were more aggressive and called for greater reforms to occur in a quicker period, and I would have preferred to see the NAIC stick to some of the objectives considered in earlier versions.

The licensing section of the action plan is particularly modest and includes five initiatives: (1) development of a single uniform application; (2) implementation of a system whereby agents and brokers need only satisfy their home state pre-licensing and continuing education requirements; (3) consolidation of all limited lines into a core group of license types; (4) full implementation of

an electronic filing/appointment system; and (5) implementation of an electronic fingerprint system. Let me address each of these in order:

- *A single application* – Several years ago, the NAIC developed uniform applications for individual producers and business entities, and most states accept these applications today. The NAIC's Producer Licensing Model Act provided that these are the applications to be utilized for both resident and nonresident licensing purposes, and any state that enacted the model should not have a state-specific application today. In addition, according to NIPR's website, all but four states (Florida, Hawaii, New York, and South Carolina) accept one or both of the uniform applications. While the NAIC's stated goal of developing a single application is apparently satisfied already, I would urge the NAIC to promote its use among the states for both resident and nonresident licensing purposes.

- *Pre-licensing and continuing education* – The NAIC's Producer Licensing Model Act already provides that agents and brokers need only satisfy their resident pre-licensing education and continuing education requirement, and any state that has enacted the model or true licensing reciprocity should have satisfied this objective already. As noted earlier in my testimony, however, some states have deviated from the model and others have not enacted it at all. It would be helpful for the NAIC to identify which states have not enacted parts or the entirety of the model and to urge action on those elements.

- *Consolidation of limited lines licenses* – Although this is an important issue, it is not the most pressing issue for most insurance agents, and I also wonder what steps the NAIC intends to take to eliminate the proliferation of limited license types.

- *Implementation of an electronic filing and appointment system* – Earlier drafts of the NAIC's new action plan called for a fundamental reworking of the appointment process and the creation of a registration system whereby insurers would simply maintain a list of the producers with whom they have a contractual relationship. Insurers would have been required to file this list on a quarterly or other basis with the appropriate regulatory authority. Unfortunately, this stronger and more reform-oriented proposal was left out of the final plan, and it appears as though the NAIC's objective is to simply recreate the current appointment process in electronic form.

- *Implementation of an electronic fingerprint system* – The NAIC acknowledges that it will need assistance from state and federal legislatures to make this a reality, but certain concerns remain. Specifically, the stated goal of uniformity will be undermined if individual states begin to enact state-specific fingerprint or background check statutes without centralized access to criminal histories or common procedures. In my view, a prerequisite for this objective would be authorization from Congress for state regulators to have access to federal criminal databases, along with the requisite protections and safeguards, as proposed last Congress in H.R. 1408.

The action plan also includes three licensing objectives for NIPR: (1) The creation of use of National Producer Numbers; (2) acceptance of electronic appointments and terminations or

registrations; and (3) use of electronic funds transfers for payment of licensing fees. While the first and third objectives would be helpful reforms, the appointment process is in need of far greater scrutiny and fundamental change than is called for in the action plan.

From an agent's perspective, I would encourage the NAIC to also consider the following issues as the regulators continue to build upon the progress that has been made to date:

- *Enable agents and brokers to apply for and obtain nonresident licenses via an electronic, web-based, single-point-of-filing system.* Most states require potential licensees to submit paper forms, a practice which unnecessarily slows the licensing process. States should take advantage of the significant progress that NIPR has made in developing a technological infrastructure for electronic licensing, and this system should be expanded to incorporate nonresident renewals as well. If there are barriers to the implementation of the NIPR nonresident licensing process, these should be identified and eliminated. Today, about one-third of the states accept electronic nonresident license applications, and many of those only accept applications from individuals.

- *Eliminate letter of certification requirements and utilize the PDB to confirm whether an agent or broker is licensed and in good standing.* These requirements might have been the most effective way to verify licensure status in the past, but they unnecessarily slow the licensing process today and make it difficult for producers and insurers to serve clients in a timely manner. The same information provided by a letter of certification can be obtained instantaneously by a regulator on the PDB. The PDB is actually a more reliable source of this information, since it can be maintained and checked in real time and provides regulators with the most current licensing information available.

- *Eliminate all paperwork and administrative application requirements that are not part of the uniform applications.* Unfortunately, many states continue to impose additional paperwork requirements in connection with an application, which is inconsistent with the principles of both licensing reciprocity and uniformity and perhaps the laws of many states.

- *Establish uniformity in the license renewal process.* There is little uniformity in the license renewal process today, and states renew licenses at different times of the year and utilize different methodologies to determine when the license is set to expire. Greater standardization would ease the tremendous administrative burden that is imposed on multi-state agents and brokers. The NAIC has adopted a series of uniform standards, but little action has been taken on these standards at the state level.

I also wanted to take the opportunity to comment on the "speed-to-market" section of the NAIC's action plan. For the most part, the objectives outlined in this section of the action plan are procedural, rather than structural, and it was somewhat disappointing that the document did not consider additional market-oriented reforms that rely more heavily on the forces of competition. In addition, the objectives contained in the action plan include timeframes that are distant, with most calling for implementation or enactment by the end of 2008. In my view,

product regulation reform most be broader than what the NAIC has proposed, and it must come about quicker than December 2008.

IV. Federal Chartering

There is widespread consensus among observers – including state and federal legislators, regulators, and the insurance industry – that insurance regulation needs to be updated and modernized. There is disagreement, however, about the most effective and appropriate way in which to obtain needed reforms. Some support pursuing reforms in the traditional manner, which is to seek legislative and regulatory improvements on an ad hoc basis in the various state capitals. A second approach, pursued by several international and large domestic companies, calls for the unprecedented establishment of full-blown federal regulation of the insurance industry. The call for federal regulation concerns me deeply.

Although the proposed optional federal regulation proposals might correct certain deficiencies, the cost is incredibly high. The new regulator would serve to add to the overall regulatory infrastructure – especially for agents and brokers selling on behalf of both state and federally regulated insurers – and undermine sound aspects of the current state regulatory regime. As an agent who is licensed in over 20 states, I can assure you that the last thing I want to do is get an additional license through a bureaucratic federal agency. As an independent insurance agent, I write for more then one company, and surely some companies would choose a federal option while others would continue to be regulated at the state level, which would force me to get dually licensed.

The best characteristics of the current state system from the consumer perspective would be lost if some insurers were able to escape state regulation completely in favor of wholesale federal regulation. As insurance agents and brokers, we serve on the front lines and deal with our customers on a face-to-face basis. Currently, when my customers are having difficulties with claims or policy, it very easy for me to contact my local company representative or a local official within the state insurance department to remedy any problems. If insurance regulation is shifted to the federal government, I would not be as effective in protecting my consumers, as I have serious reservations that some federal bureaucrat on a 1-800 number will be as responsive to a consumers needs as a local regulator. Federal models propose to charge a distant and likely highly politicized federal regulator with the implementation and enforcement of a single set of rules that would apply equally across all States and all insurance markets. Such a distant federal regulator may be completely unable to respond to insurance consumer claims concerns and its mere creation could spark fears that this will prove to be the case. As a consumer, specifically in terms of personal lines, there would be confusion as to who regulates their policy, the federal government or the state insurance commissioner. I could have a single client that has several policies with one company that is regulated at the federal level, while at the same time having several other policies which are regulated at the state level. Nor can a single regulatory system harmonize the diversity of underlying state reparations laws, varying consumer needs from one region to another, and differing public expectations about the proper role of insurance regulation. The potential responsiveness of a federal regulator to both industry and consumer needs in several critical areas could therefore jeopardize the fundamental purpose of insurance regulation and must be considered questionable at best.

One of the primary concerns I have with any federal regulation proposal is the political reality associated with legislation being considered by Congress, especially a proposal of this magnitude. The proponents of optional federal chartering equate federal regulation with deregulation, and their proposals call for an elimination of product regulation and an exemption from many of the requirements and consumer protections that states have in place today. Such a proposal would be impossible to pass through Congress in that form, and any bill adopted by Congress will undoubtedly include a host of other provisions. Any optional federal chartering legislation can be expected to include many onerous mandates and requirements, including anti-redlining provisions, unprecedented disclosure and Community Reinvestment Act-like requirements, oversight by the Federal Trade Commission and other federal agencies, expanded privacy provisions, credit scoring and claims history restrictions, strict rate and form filing and approval requirements, and other purported consumer protections.

During the last two sessions of Congress, two federal regulation proposals have been formally introduced, and, ironically, both were strongly opposed by all aspects of the insurance, including those insurers that support optional federal chartering. The most recent proposal is the Insurance Consumer Protection Act (S. 1373), which was introduced earlier this year by Senator Fritz Hollings (D-SC). S. 1373 would create the "Federal Insurance Commission," an independent panel to be housed within the Department of Commerce, and the commission would be the sole regulator of all interstate insurers offering property and casualty or life insurance. This legislation would also repeal the McCarran-Ferguson Act's antitrust exemption.

There are several key components to S. 1373 that I strongly object to. Under this legislation, the newly formed commission would have full authority over rates and policy substance, a step towards command-and-control regulation and away from a more appropriate reliance on competitive forces. The federal commission would be responsible for establishing licensing standards for the insurance industry; conducting annual examinations, solvency reviews, and market conduct examinations; and establishing accounting standards. The bill would also allow the commission to investigate the organization, business, conduct, practices and management of "any person, partnership or corporation in the insurance industry", and it would appear that insurance agents and brokers fall under this definition. I am specifically troubled that this legislation places the responsibility for regulating all multi-state agents with what will be a massive and untested Washington bureaucracy. While there are problems with the current licensing system, adding another layer of regulation on top of this would create significant problems.

Unfortunately, S.1373 takes the worst elements of the current state system and shifts them to the federal level, where there is even less accountability and potentially greater politicization. This legislation is a perfect example of what can happen when an industry goes to Congress asking for help. Very often, the final result winds up being far worse than the problems that were to be addressed and rectified. Plus, as we all know, once a new federal bureaucracy is established in Washington, it only grows larger and more powerful, so once we get federal regulation, there will be no hope of ever rolling it back if it fails.

V. A Middle Ground Solution

It is clear that there are deficiencies and inefficiencies that exist in state regulation today, and there is no doubt that the current state-based regulatory system should be reformed and modernized. At the same time, however, the current system is exceedingly proficient at ensuring that insurance consumers – both individuals and businesses – receive the insurance coverage they need and that any claims they may experience are paid. These aspects of the state system are working well, and I have little doubt that this Subcommittee will hear any testimony to the contrary. The optional federal regulation proposals, however, would displace these well-running components of state regulation as well and, in essence, thereby "throw the baby out with the bathwater."

What I believe is needed is a *third way* – a mechanism that builds on, rather than dismantles, the states' inherent strengths to meet the challenges of a rapidly changing insurance environment. Such a proposal must modernize areas in which existing requirements or procedures are outdated, while imposing effective regulatory oversight and necessary consumer protections. It must also include create more uniform and consistent requirements and regulatory procedures and ultimately lead to a more efficient, modernized, and workable system of insurance regulation.

In addition to serving as President and CEO of SouthGroup Insurance and Financial Services, I am also an active member of the Independent Insurance Agents and Brokers of America (IIABA). For the last year, IIABA has been spearheading a cooperative attempt to develop just such a proposal. They have been working with state policymakers, other trade associations, and an array of national and regional insurers in an effort to identify precisely what must be fixed and how that might be done without displacing the components of the current system that work well and without creating additional layers of governmental bureaucracy. Through this process, IIABA has been targeting those areas in the current regulatory system that need to be fixed, rather then scrapping the whole system all together.

Although the IIABA proposal is misinterpreted and mislabeled by some, the association is essentially calling on Congress to use the legislative tools at its disposal to overcome the structural impediments to reform and ultimately achieve a more efficient and effective regulatory framework. In other words, we advocate using federal legislative action to bring about greater consistency and other needed reforms across state lines. In this way, we can assure that insurance regulation will continue to be grounded on the proven skills and experience of state regulators.

The key to this approach is that it will lead to a more uniform and market-oriented system on a national basis while preserving and strengthening the regulatory infrastructure at the state level. It will also allow many overdue reforms, including much of the NAIC's regulatory reform agenda, to take effect countrywide following the adoption of a single legislative act. This pragmatic concept addresses many of the legitimate criticisms lodged against the current system and would improve and enhance state insurance regulation without replacing it altogether.

The "federal tools" or "uniform treatment" approach can be applied to nearly every important area of insurance regulation, including those issues most in need of reform. For example, such a

bill could address product regulation, agent and company licensing, market conduct exams, auditing procedures, corporate governance, and a variety of other areas. At the same time, Congress has a wide variety of legislative tools at its disposal, including the implementation of national reciprocity or uniformity and the preemption of state law. Accordingly, one of the benefits of IIABA's approach is that it allows different legislative tools to be utilized in a tailored fashion on an issue-by-issue basis.

Working in conjunction with other groups interested in this approach, IIABA continues to consider the potential applications of this concept. Although this development process is still underway, there are some areas where our work is more evolved and refined. In order to give you some perspective concerning the possible applications, I have highlighted some of the ways in which this approach could perhaps be implemented, focusing below only on producer licensing and speed-to-market issues.

- *National Licensing Reciprocity* – In the licensing arena, we propose implementing reciprocity on a 51-jurisdiction basis and preempting all non-resident licensing laws that are inconsistent with the GLBA/NARAB standards. By using Congress's preemptive authority, we could provide that a producer licensed in his/her home state may obtain a non-resident license by simply completing the NAIC's uniform application and paying the requisite fee. Similarly, such a federal law could preempt non-resident continuing education requirements and other requirements that have the effect of limiting or conditioning a non-resident's activities solely because of that person's residence or place of operation.

- *National Uniformity* – Additional uniformity is necessary in producer licensing, and federal legislation could be used to establish greater multi-state consistency. One way in which to obtain uniformity through such a vehicle would be to prohibit a state from licensing non-residents unless the state agrees to abide by certain uniformity standards. Such uniformity standards could address a broad array of issues, including, but not limited to, resident licensing requirements, the licensing cycle and renewal process, entity licensing, the use of the Producer Database, etc.

- *Appointment Requirements* – Through the use of preemption, a proposal of this kind could help revolutionize the appointment process or lead to the elimination of appointment filings altogether. Appointment requirements could be preempted outright, perhaps with a limited savings clause for certain narrower requirements.

- *Countersignature Laws and Other Restrictive Barriers* – This type of proposal could also provide for the outright preemption of countersignature laws and similar barriers to effective multi-state commerce.

- *Prior Approval Requirements* – In the area of product regulation, most or all prior approval requirements could be preempted by Congressional action.

- *Parameters for Rate and Form Review* – Through the use of preemption, a federal proposal could establish parameters for the purpose of standardizing and streamlining the

> review and approval of insurance products. This could be done on the form side, for example, by making a traditional file-and-use system (with a strict deemer provision, limited to 30 days, and other mandates) the most stringent form of review available to state regulators. Rate regulation could be addressed in similar ways, and IIABA supports using preemption to move to a competitive rating system that would eliminate the traditional review and approval of rates and only require rates to be filed electronically at the time they are introduced in the marketplace.

If the IIABA proposal were to become law, I believe it would remedy 95 percent of the problems with the current regulatory structure. From an agent and broker's perspective, I can assure you that licensing burdens facing my agency and employees would be reduced dramatically with such a proposal. Just as important to agents and companies is our desire to get products out to our customers as quickly as possible, and we are confident that we can realize such reforms by utilizing this philosophical approach to reform. As you can see, a proposal like IIABA's would alleviate most, if not all, agent and company concerns while still leaving the day-to-day regulation at the state level and without transferring power to a new federal bureaucracy in Washington.

VI. Conclusion

Although I continue to support the preservation of state regulation of the business of insurance and applaud the efforts that the NAIC and state legislators are making, I believe that additional reforms to the current system are necessary and essential. Specifically, I believe the best alternative for addressing the current deficiencies in the state-based regulatory system is a pragmatic, middle-ground approach that utilizes federal legislative tools to establish a more uniform system and to streamline the regulatory oversight process at the state level. By using federal legislative action to overcome the collective action hurdles and structural impediments to reform at the state level, we can improve rather than replace the current state-based system and in the process create a more efficient and effective regulatory framework.

Testimony of Jaxon A. White, Chairman & CEO
Medmarc Insurance Group, Chantilly, Virginia
November 5, 2003
Financial Services Committee – Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

Good afternoon Chairman Baker, Ranking Minority Member Kanjorski and other members of the Subcommittee. I'm Jaxon White, the Chairman and Chief Executive Officer of the Medmarc Insurance Group. I appreciate the invitation to appear before the Subcommittee and offer my views on efforts to reform state insurance regulation.

The Medmarc Insurance Group has been in business for 24 years and I have served as the chief executive officer for the last 19 years. The Group consists of three property and casualty insurance companies. In the business structure, the top organization is a mutual insurance company which then owns two stock insurance companies. The mutual company and one subsidiary are domiciled in a single state and the other stock company has a different state of domicile.

My goal for this appearance is twofold. First, I wish to thank the Members for exploring the possible role of the Federal government in the regulation of insurance among the states. My second purpose is to assist the Subcommittee by making certain points about the challenges of state by state regulation from the perspective of a small insurance company.

Medmarc is a small insurer by most assessments. In 2003, net premiums written will be $75.0 million. We have a staff of 60 persons and offer products liability insurance coverage to manufacturers and distributors of medical technology. Our customers are also our owners since we are a mutually owned and controlled group. Our customers, both current and prospective policyholders, are based in all 50 states and the District of Columbia. To effectively reach and serve these customers, we do business through the two stock insurance companies – one for admitted coverage and one for non-admitted coverage. A non-admitted insurer is also commonly referred to as a surplus lines carrier. Both companies have licenses or authority to operate in 50 states. As such, we are obliged to comply with licensing, reporting and filing for 100 rights to do business.

We support state regulation of insurance but believe it should become more rational to accommodate and sustain small insurance companies. It may interest the Committee to know that we have no competitors of similar size. Our competitors are very large insurers with much different economies of scale in dealing with state regulators and their varying requirements. That is not to say that state regulation is any better or different for big insurance companies but they do have more resources to cope with the problem, in my opinion. One solution to the problem for large and small insurers, alike, may be Federal standards. Done effectively, Federal standards would promote common interpretations of compliance, licensing and other key parts of the state regulatory system. At this juncture, it is not my objective to suggest a specific course of action. However, is

seems possible that some manner of Federal pre-emption may be needed to move state legislatures and state insurance departments toward a baseline for reform. In the following comments, I would like to illustrate some of the problems with inconsistent regulatory practices and rules that lend themselves to reforms aimed at consistent interpretation and treatments from state-to-state.

Insurance Company Licensing

The foundation of the state regulatory system is licensing of insurance companies. I am certainly willing to acknowledge beginning steps taken by the NAIC to encourage uniform company license applications in recent years. Regardless, our experience may be instructive as to how company licensing is a competitive barrier to entry for a small insurance company. Prior to 1995, we conducted business as a reinsurance company under a business arrangement with a large insurer. Operating as a reinsurer, our minimum legal requirement was a license in just one state. The large insurer, licensed in all states, issued coverage and our company reinsured most of the loss exposure. The agreement was vital to the growth of our company while we accumulated sufficient capital and experience to reach a threshold for licensing. As we contemplated our options in the three years before 1995, it was clear that we could not become a licensed company in all states within any less than **five** years and probably longer. The company licensing process in 1995 was insurmountable for a small insurance company that had to have approvals in all 50 states. We turned to a pragmatic and expensive solution. We bought an admitted insurance company corporate shell that had licenses in 47 states. The transaction cost was $3.6 million and it consumed just under ten percent of our policyholder surplus. The decision to purchase the shell insurance company was the right course of action for that time period and I do not regret the choice. It gave our Company a means of business independence because we could begin to issue insurance coverage in most states. The migration of our policyholders from the old, dependent, arrangement to the independent arrangement took three years.

In retrospect, we were not looking for special treatment just because of the Company's small size. Nevertheless, we could not possibly enter the national marketplace as a licensed insurer in 1995, or even today, under the patchwork of company licensing requirements and do it <u>within the span of a year</u>. Taking more time than a year, in our situation, would mean the loss of business to others who already had licenses. In business, you do what you have to do to protect your financial interests from threats or barriers. In the case of state insurance company licensing, it seems fundamental and compelling to level the playing field for all companies willing to compete – regardless of size. Our story might illustrate an occasion when Federal standards for insurance company licensing would have provided a gateway for a small insurance company that otherwise had the impossible task to meet disparate rules and protracted delays for licensing in state after state.

Filing and Approval of Policy Forms

I don't wish to belabor this story but it does have another installment. After acquiring the admitted insurance company in 1995, we faced a range of new hurdles in the vast differences among state regulatory systems. We encountered problems with the next step

in the process; the approval of policy forms. Among other filing obstacles, a key issue for us was a barrier in some states disallowing a desirable policy form known in the industry as claims-made coverage.

Coverage under the claims-made policy form allows a small or a large insurer to price coverage for the expected loss experience but only for claims that are reported to the insurance company during the policy period. Some states do not allow insurers to write this coverage form but there is no sound basis for this decision, in our opinion. As a practical effect, we cannot offer the claims-made policy form in one state while it is permitted in a neighboring state.

We coped with the policy form barrier for several years by offering different coverage forms in different states. The predictable outcome of varying the coverage form is complexity in setting rates and uncertainty in striving for an annual underwriting profit. I am not suggesting that our business was imperiled but it was more expensive to operate and profit-planning became more difficult. Faced with these business challenges, we decided to purchase another shell insurance company with approvals in 48 states to write business as a surplus lines or non-admitted insurer. The price tag for this corporate shell was $3.5 million. That is a small number for a large insurer but another large cost to a small insurance organization.

The surplus lines company was acquired in 2001 and it was an immediate road to a business solution but not a lower cost of doing business. Policy forms and rates used by a surplus lines insurer are historically insulated from filing and approval requirements in all states. The primary reason for purchasing the surplus lines company was a certain freedom from large differences in policy form regulation from state-to-state. We did not purchase the shell to avoid constructive state regulation. We did purchase the company to bring more uniformity to coverage offerings. In our view, the accident of a policyholders' business location in one state versus another state should not be a barrier to purchasing commercial property or casualty insurance that is desired by the customer rather than dictated by regulatory practices.

There are many subtleties that can be debated between the merits of admitted coverage versus surplus lines coverage. However, my purpose in telling our story is focused on the big picture. Perhaps the following question is worthy of reflection in the future discussion of Federal regulatory standards. Is it useful or productive for a small insurance company to spend millions of dollars to acquire the rights to offer insurance coverage with some degree of uniformity? Again, I don't have a quarrel with state sovereignty but it just seems that Federal standards could create a more conducive regulatory climate and allow a small insurer to compete more effectively in the market.

Market Conduct Examination

Another area of focus is market conduct examinations and the need for much better application and interpretation of rules. This area cries out for consistency for a small insurance company. At the outset, I wish to state that our companies are very serious about compliance with market conduct. The problem we encounter is how to properly

anticipate the correctness of our actions from state to state. I am not suggesting that we should have a national playbook on how to build a satisfactory program for market conduct. On the other hand, we do need a much better picture of market conduct priorities within all state insurance departments. The consumer protection purposes of market conduct examinations are not disputed by any insurer. The problem arises when consumer protection becomes a big curtain to hide many unsuspecting pitfalls from a small insurer.

In our limited experiences with market conduct, we know that mistakes have been made, observed by the examiners and corrected to their satisfaction. Nevertheless, the market conduct process is intimidating for a small insurer because we don't know how a particular state will interpret rules or find infractions that would be immaterial in the practices of another state insurance department. As I noted earlier, we market and sell a tailored insurance product for a target audience. The appeal of our Company to the insurance brokers and policyholders is flexibility in coverage terms and associated pricing. If market conduct compliance was our overriding business objective, we could simply offer approved forms and follow loss cost data published by the Insurance Services Office, of which we are a member. But our dominant business objective is meeting the needs of our customers. To achieve this goal, we frequently vary policy terms, conditions and pricing to satisfy the wants and needs of the customer. The trouble arises when there is an overlay of business uncertainty about whether our underwriting decisions and processes will run afoul of market conduct compliance notions.

The choice between market compliance and meeting the customer's needs is not black or white. Our insurance companies want to satisfy the requirements of law and regulation in every state where we do business. The current environment for market conduct variability among the states does not lend itself to an acceptable degree of certainty in operating a small insurance company business. Some observers in the industry have suggested that market conduct fines are frequently disproportional to the infraction. In larger companies, a market conduct fine may be just another cost of doing business. A market conduct fine or other sanction, in our case, could have major consequences due to our small size. In the end, we try to do the right thing by conscientious underwriting and pricing that follows the best assessment of satisfying market conduct. Months or years later, those business decisions may be viewed in a completely different light by a market conduct examiner. We would cast a vote for Federal standards in the area of market conduct because it just makes sense to a small insurer.

Potential Role for Federal Standards

In the preceding comments, I have tried to illustrate some key areas where a small insurer with a nationwide business opportunity is disadvantaged by delays and differences in the regulation of insurance from many states. My purpose today is not asking for a free pass because of our small size and I am not here to castigate state regulation of insurance. But our companies have seen and experienced so many instances where regulations in one state seem trivial while those in another state become, in effect, a national standard for conducting our business affairs.

The insurance regulatory matters before the Subcommittee in the past and today are very important to our Company and all other insurers, big or little, that want to serve a customer base in numerous states. In the simplest of terms, we sell a promise to pay when our policyholder has a liability claim. Our business credo is to serve the needs of a constantly changing liability picture for policyholders while continuing to build our financial strength. A claim for liability can arise in any state at any time and the claim doesn't neatly fit into the boundaries of insurance coverage protection as defined by any one state that happens to be the policyholder's place of business. I encourage the Members of this Subcommittee to continue your gathering of facts, experiences and opinions about the movement toward Federal standards that could improve selected areas of state insurance regulation.

Statement of Neal S. Wolin
Executive Vice President and General Counsel
The Hartford Financial Services Group, Inc.

Before the

Capital Markets, Insurance & Government Sponsored Enterprises Subcommittee
of the House Financial Services Committee

November 5, 2003

Good afternoon Mr. Chairman, Congressman Kanjorski and members of the subcommittee. My name is Neal Wolin and I am Executive Vice President and General Counsel of The Hartford Financial Services Group. The Hartford is one of the nation's oldest and largest investment and insurance groups. Our property-casualty and life companies offer products to both individuals and businesses.

I am grateful to share my perspective today on how Congress can reform insurance regulation. My testimony will focus on three areas. First, which areas of the present regulatory structure most require reform? Second, can the states meet these needs without federal intervention? Third, what can Congress do to ensure necessary regulation while also permitting insurers to deliver insurance products quickly and at competitive prices?

Need to Modernize Insurance Regulation

Insurance has become a multi-billion dollar industry providing personal and economic security across state borders. Yet, our regulatory system remains a creature of unique historical development and is more suited to the 20th than the 21st century. Our present structure adds unnecessary costs to insurance products and restricts our ability to meet consumer preferences. The patchwork of state guaranty fund structures and post-insolvency assessments on insurance companies complicates the protection of policyholders and claimants from insurer insolvencies.

I would like to highlight three areas as most critically in need of modernization: forms, rates, and solvency.

FORMS. Insurance companies must file forms for most product lines in each jurisdiction in which they seek to operate. For a national carrier, that means filing in each of the 50 states and the District of Columbia. These 51 jurisdictions have different standards for form approval. In industry jargon, the standards range from "use and file", to "file and use", to "prior approval". Even when States have the same standard in name, their regulators may interpret filing requirements differently.

To give you a sense of impact on our operations, our property-casualty companies make an average of 5,500 filings each year with the 51 jurisdictions. These filings are then reviewed in each of the 51 jurisdictions and often result in lengthy dialogue between our lawyers and actuaries and insurance department personnel. If significant changes are made in one jurisdiction, we may need to restart the process with jurisdictions that have already approved the forms. Our life insurance and annuity

products with investment features compete against mutual funds and other products that are subject to one-stop federal regulation – while we are forced to file 2,500 product forms in 51 jurisdictions.

This elaborate process is burdensome on our industry, but more importantly, has negative effects on the customers we seek to serve. First, consumers ultimately pay the cost of our compliance with this regulatory scheme through higher premiums. Second, the complexity of the process interferes with our ability to get new products to consumers rapidly. We live in a time when consumer preferences change rapidly, and when industries generally are judged by their ability to discern and meet these changing preferences. In contrast, it can easily take more than a year in our industry to secure the approvals necessary to market a new product nationally.

RATES. Price controls should be used as a regulatory tool only as a last resort, and only after market-based efforts have failed. The insurance industry is marked by robust competition; it is very unusual for any company to enjoy more than single-digit market share in any market. Competition between companies should and can establish prices at the most consumer-friendly prices. Government price controls distort the connection between risk and price, and ultimately hurt the consumer or lead insurers to withdraw from the market. Nevertheless, after forms are approved, the insurance industry must run the regulatory gauntlet a second time to attach prices to products. As already mentioned, this 51-step process adds time and expense in getting our products to consumers.

CAPITAL ADEQUACY. Addressing rate and forms concerns does not mean ending all regulation. Strict anti-trust adherence is necessary to protect consumers from over-pricing of products. But strict solvency regulation is also needed to protect consumers from under-pricing by companies willing to collect premiums now and avoid claims payments later by declaring bankruptcy. The current regulatory system has unfortunately failed to provide even this most basic level of protection. When States force companies to remain in markets and sell products at artificially low prices, companies flounder. State guaranty funds are forced to pick up the pieces, and pass the costs on to insurance policy holders or taxpayers. To illustrate rapidly changing stress on the system, guaranty funds paid out $10 billion in their first 30 years and an additional $3 billion just last year.

Forms, rates and solvency may be the most significant areas of insurance regulation needing modernization, but there are others. Oversight by multiple jurisdictions has led to costly and duplicative examinations of insurance market conduct. Consolidation would produce more useful examinations at a fraction of the cost. Licensing requirements in 51 jurisdictions impose barriers to market entry that mean less competition. And unique regulatory regimes have resulted in complex corporate structures that add cost to the insurance product.

NAIC Role and Regulatory Modernization

Nearly 20 years ago, a predecessor of this Committee investigated the ability of state regulators to perform the twin missions of company solvency protection and consumer protection. The subsequent report and hearings produced headlines on deficiencies in both areas. Since then, the NAIC and many active individual

commissioners have strived to improve consistency, quality, efficiency and speed. They have worked in good faith, but the actual reforms have been too slow in coming. In fact, the NAIC's Action Plan, adopted less than two months ago, echoes many of the initiatives announced and pursued over the past two decades. The plan strives for greater standardization and speed, but leaves the state structure in place. Most importantly, its timeline for completion stretches to the end of this decade.

At this Committee's initiative, the GAO recently studied efforts of the states and NAIC to streamline and modernize market conduct. GAO observed "that the NAIC has been pursuing (these) initiatives since the 1970s but progress has been limited". Further, it suggested that "result has been inconsistent and often spotty coverage from state to state, and (resulting in) potential gaps in consumer protection". GAO concluded that much work needed to be done. The GAO study also cautioned that it was uncertain not only when but even whether the NAIC and the states could accomplish this goal. We share that concern, and believe that any plan which continues to rely on a structure of fifty-one regulators will not produce the modernization necessary for our customers.

Optional Federal Charter

The Hartford believes that the solution that best provides value to consumers and the economy is one that grants national insurers the level of federal oversight offered to other large financial institutions. Our companies and products already receive significant federal oversight or regulation. Congress is increasingly addressing societal issues critical to our industry, such as terrorism, asbestos, litigation abuses. Consumers are influenced by federal taxes when deciding to purchase our products. And our companies' ability to compete is often governed by federal tax legislation affecting U.S. companies and our competitors.

We believe, therefore, that Congress should develop legislation permitting companies the option to be chartered and regulated at the federal level. This legislation need not totally eliminate regulation of products or companies. Policyholders, claimants and taxpayers will all be well-served by regulation that is standardized, efficient, objective and time-sensitive. I am convinced that federal regulation will do a better job meeting consumer demands, provide for more competitive prices and safeguard the solvency of insurers.

The watch-word here is optional. If state, regional or national insurers believe that their customers and the marketplace will be better served by the NAIC's present pace of improved state regulation, they will have that choice. Clearly, the insurance industry should have the same regulatory options as the banking industry.

Thank you again for the opportunity to appear here today and comment on this important issue.

Statement of the American Land Title Association
on
"Reforming Insurance Regulations-Making the Marketplace more Competitive for Consumers"

The American Land Title Association* represents title insurance and settlement service providers. Of all the lines of insurance, none are as inextricably linked to state and local conditions as the title insurance industry. The focus of title insurance is the protection of the interests of owners, investors, lenders and others in real estate. The underwriting of title insurance involves a review and assessment of state and local records affecting titles to real estate. Title insurance policies are issued in connection with inherently local transactions – real estate settlements and mortgage loan closings. Reflecting the diversity of state and local laws and practices regarding real estate, the practices and processes by which title insurance is issued will frequently vary from state to state, and even from region to region within a state.

As a consequence, ALTA and its members strongly believe that regulation of the title insurance industry should continue to be the province of the various states. Federal regulation of insurance, or federal chartering of insurance companies, might be appropriate for the property/casualty insurance industry – as is suggested by legislation introduced in this session by Senator Fritz Hollings (D-SC) "The Insurance Consumer Protection Act of 2003 (S. 1373). However, such regulation and chartering is unnecessary for the title insurance industry, and would only serve to undermine the effectiveness of state regulation of our industry.

That is not to say that state regulation of title insurance cannot be improved. However, most of the concerns about state regulation that have been advanced by those who support federal chartering are simply inapplicable to title insurance. Uniform licensing of insurance companies is unnecessary given the number of companies who underwrite the title insurance product. Over one-third of the industry volume is written in California, a state where tile insurance companies are highly regulated and which has stringent consumer protections.

Uniform licensing of agents is counterproductive, given the various type of agents through which title insurance is provided in different states and regions of the country and the variety of laws, which they learn. Any Federal regulations should set standards as high as current

* The American Land Title Association membership is composed of 2,400 title insurance companies, their agents, independent abstracters and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in titles. Many of these companies also provide additional real estate information services, such as tax search, flood certification, tax filing, and credit reporting services. These firms and individuals employ nearly 100,000 individuals and operate in every county in the country.

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state law requirements. In many areas of the country, title insurance is provided through attorneys, who perform the title and legal and advocacy work associated with commercial and residential real estate settlements. Attorneys are licensed and disciplined through their state bar associations, do not require national licensing supervision. It would be counterproductive and illogical to require Federally licensed title insurance agents doing business in Ohio to learn South Carolina real property law, and senseless for a Federal agency to establish Federal regulations that would reflect variations in the real property law of the 50 states.

ALTA believes that problems that arise with insureds are best handled at the state level. Title claims relate to the specific real property involved. It is unlikely that Federal agencies would be in a better position to remedy these specific problems than local courts. Further, some title problems are solved through such methods as remedying foreclosures that reflect state specific law. Again, this is an area where Federal regulators are unlikely to have better expertise than state regulators.

Solvency issues are also best addressed at the state level. In fact, title insurance companies are so well regulated at the state level that only one state—Texas-- has established a state guaranty fund.

In sum, we do not believe that there is a need for alternative federal chartering of title insurance companies, or for greater federal regulation of the title insurance industry. We look forward to working with the Committee as work on this issue proceeds.

Public Policy Monograph

April 2003

Role of the Actuary Under Federal Insurance Regulation

American Academy *of* Actuaries

AMERICAN ACADEMY *of* ACTUARIES

The American Academy of Actuaries is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the actuarial profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice and the Code of Professional Conduct for all actuaries practicing in the United States.

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Role of the Actuary Under Federal Insurance Regulation

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Section I. Executive Summary

For over 100 years, the American insurance industry has been regulated by the states. However, as a result of the 1999 Financial Services Modernization Act and other changes in the financial services industry, various proposals have been submitted that would allow insurance companies the option to be federally regulated. The role of the American Academy of Actuaries (the Academy) in the proposed federal charter debate is not one of advocacy or opposition. Instead, we believe our role is to fully participate in the discussions to provide actuarial assistance in the design of any altered insurance system.

The primary purpose of government regulation is to protect consumers, particularly to protect the solvency of companies so they can fulfill their promises to policyholders. Within the insurance industry, actuaries have been the professionals most actively involved in helping state regulators protect solvency. Actuaries analyze and shape insurance regulations that preserve the financial integrity of the insurance system through sound programs and strong companies, by assuring that companies comply with these requirements in a regulatory capacity, and by overseeing the fulfillment of these requirements within companies. Membership in the Academy is the primary credential qualifying actuaries to make this contribution.

This monograph has been prepared by the Academy's Federal Charter Work Group in response to our review and analysis of the current proposals for federal insurance regulation. The Academy's interest in the optional federal charter proposals is to ensure that the customers and other stakeholders in a federally regulated insurance system have the appropriate protections. We are convinced that this protection can best be accomplished if any legislation enables actuaries to perform their vital role in the analysis and management of company insolvency.

Based upon our analysis of the current proposals for an optional federal insurance charter, it is our view that any legislation must clearly address the role of the actuary. We therefore recommend that the following essential components be incorporated into any laws that implement a federal insurance regulatory system:

Component 1: Establish an Office of the Chief Actuary to regulate and supervise the actuarial and solvency requirements of federally regulated insurance companies.

Component 2: Require that the Office of the Chief Actuary be involved in actuarial aspects of the federal insurance department's development of regulations and pronouncements related to solvency protection.

Component 3: Define the responsibilities of the Office of the Chief Actuary regarding the review of federally regulated insurance companies.

Component 4: Define the minimum actuarial requirements that federally regulated insurance companies must meet and submit to the Office of the Chief Actuary.

It is our belief that including these components in any potential federally regulated insurance structure is fundamental to the objective of protecting insurance consumers and preserving the financial integrity of the insurance industry.

Section IV of this monograph provides more detailed information regarding each of these components. Sections II and III, provide background information regarding financial security programs, insurance, the actuarial profession, and the role of the actuary in helping shape insurance regulations.

Section II. Financial Security, Insurance, and Regulation

Financial Security and Insurance

Individuals and businesses are exposed to many risks that can have devastating consequences to financial security. These risks include:

- Property damage and loss from accidents, fire, and storms
- Loss of income from poor health, disability, or premature death
- Insufficient assets to fund retirement or long-term care needs
- Unanticipated hospital, medical, and dental health care expenses
- Liability arising from operating a business, performing a service, driving a vehicle, or personal actions

The financial consequences of these risks can be avoided, reduced, or transferred. For any particular individual or business, it is extremely difficult to predict the likelihood or impact of a specific peril. To address this situation, financial security programs are established to manage the risk and mitigate adverse financial effects on individuals and businesses.

Insurance, including reinsurance, is one of the most common components of a sound financial security program. By utilizing risk-sharing and risk classification techniques, insurance transfers the potentially large financial consequences that an individual or entity might incur to all the insured members of a group or cohort for a smaller known cost or premium.

Insurance companies are in the business of providing products that will facilitate the management of financial risks associated with these perils. By utilizing probability theory, statistical data, and mathematical models, actuaries determine prices (premiums) for insurers' products. For many insurance products, the costs change significantly with characteristics such as attained age, policy duration, medical or driving history, and so on.

The insurance laws and regulations require insurance companies to establish appropriate reserves for anticipated future claims as well as for known claims and to maintain adequate solvency in order to provide the financial security expected by the policyholders.

In the process of providing insurance and other financial services, insurers are also major providers of funds to the capital markets.

Role of the Actuary in Insurance Regulation

The current state-based structure of insurance regulation has been in place since 1869. Many actuaries play a vital role in the design and operation of this structure as employees of insurance regulators. Many more serve as advisors to the regulators —either individually as interested persons or as members of the Academy committees that make recommendations to the regulatory authority.

The primary responsibilities of the regulatory actuary are:

- Monitoring the solvency and financial condition of domestic insurers by reviewing companies' reserves and risk-based capital calculations, and the Statements of Actuarial Opinion provided by each company's Appointed Actuary
- Reviewing product-related Actuarial Certifications for compliance with prescribed laws and regulations
- Evaluating the reasonableness of premiums for certain insurance plans
- Advising the Commissioner on the impact to the public and others of acquisitions, demutualizations, and mergers
- Assisting the Commissioner in managing the rehabilitation or liquidation process for troubled insurance companies
- Developing and implementing changes to insurance laws and regulations concerning proper reserve levels, premium rates, accounting and solvency requirements

Actuaries who work for organizations in or serving the insurance industry are actively involved in helping analyze the impact of new or proposed insurance regulations. By working collaboratively with industry trade groups, public policy-makers, and regulators, actuaries help to shape new regulations. The American Academy of Actuaries is the principal professional organization through which actuaries make this contribution.

Section III. The Actuarial Profession

What is an Actuary?

The Academy has over 14,000 members uniquely qualified for measuring and managing the risk in financial security programs. Actuaries share an expertise in assessing risk, designing insurance programs, establishing prices for these programs, and ensuring that these programs are maintained on a sound financial basis. Actuaries also employ a broad knowledge of business, economics, finance, mathematics, and statistics to evaluate the financial implications of uncertain future events such as death, sickness, injury, disability, extreme medical costs, or property loss. In addition, many actuaries are involved in setting company policies and are often called on to explain complex technical matters to company executives, government officials, shareholders, policyholders, or the public.

Most actuaries are employed in the insurance industry by consulting firms, insurance companies, or regulatory agencies. In addition, many non-insurance financial service institutions such as banks and securities firms also employ actuaries. Due to the complexity of financial security programs, actuaries, much like other professions, choose a specialty. Actuaries will generally specialize in a particular practice area emphasizing annuities, health insurance, life insurance, property and casualty insurance, or pensions.

Actuaries need a strong background in topics such as mathematics, economics, statistics, and finance. An undergraduate degree in one of these areas is typically the start of the academic training for an actuary. In addition, a rigorous examination process is required to obtain professional designation in the actuarial profession. The successful completion of this examination process has often been compared to obtaining a doctorate or PhD in mathematics or finance.

Additional information about the actuarial profession, the Academy, and related organizations can be found in the Appendix.

Section IV. Role of the Actuary in Insurance Regulation

A financially sound insurance industry could not exist without actuaries. The actuarial profession is essential to the sound operation and structure of insurance regulation in two crucial ways.

First, as experts in assessing and managing the financial security risks that Americans face, actuaries have vital knowledge and experience in how to assess and manage these risks. By working collaboratively with industry trade groups, regulators, and public policy-makers, actuaries have helped to shape the modern regulatory system. The American Academy of Actuaries has been the principal professional organization through which the actuarial profession has educated public policy-makers in insurance and financial security risk. Our goal has been to produce reasonable and fair regulations that protect the solvency of financial security systems and the interests of all policyholders.

Second, many regulatory agencies employ actuaries. The fundamental role of state insurance regulation has been solvency protection and the actuarial profession has been very involved in this process. Regulatory actuaries ensure that companies within their jurisdiction have complied with the specific actuarial requirements included in the insurance regulations. Most important, the regulatory actuary protects insurance consumers by analyzing and monitoring insurance companies to help prevent insolvencies.

To ensure that the regulatory system protects stakeholders, such as the individual insureds, it is essential that the actuarial role and related reporting requirements continue under any federal insurance regulatory structure. **However, based upon our analysis of the various proposals for a federal insurance option, the role of the actuary is not apparent.** We therefore recommend that the actuarial role and requirements be clearly defined by incorporating the following essential actuarial components into any laws that implement a federal insurance regulatory system.

Component 1: Office of the Chief Actuary

Law should establish the Office of the Chief Actuary. The Chief Actuary would report directly to the head of the federal insurance department (the "Commissioner"). The Chief Actuary and senior supervising actuaries must be members of the Academy to assure their qualification and adherence to the Code of Professional Conduct and the Actuarial Standards of Practice.

The Chief Actuary will be responsible for staffing the actuarial division with actuarial specialists to facilitate effective regulation and supervision of all federally chartered life, health, and property and casualty insurance companies. The Office of the Chief Actuary should include separate actuarial functions headed by actuaries who meet the American Academy of Actuaries qualification standards for the type of company they are regulating.

Component 2: Involvement in federal insurance regulations

The Office of the Chief Actuary will advise the Commissioner on actuarial aspects of all regulations or other pronouncements of the federal insurance department.

Component 3: Actuarial review of federally chartered companies

The Office of the Chief Actuary will be responsible for advising the Commissioner on all actuarial matters. The key areas of actuarial involvement are intended to support the consumer protection objectives of the federal insurance department. The following list includes many of the most important actuarial functions.

- Inform and advise the Commissioner regarding companies that have solvency or financial problems based upon the analysis and review of reserve opinions, risk- based capital calculations and other monitoring tools.

- Develop and implement changes to insurance laws and regulations concerning proper reserve levels, premium rates, accounting issues that involve actuarial and solvency requirements.
- Advise the Commissioner on actuarial aspects of rehabilitations, liquidations, acquisitions, mergers, and demutualizations.
- Review and evaluate all required product related actuarial certifications for compliance with regulatory requirements.

Component 4: Actuarial requirements for federally chartered insurance companies
Insurance companies that are subject to federal regulation must meet certain minimum actuarial requirements. All actuarial requirements must be submitted by a qualified actuary who holds the MAAA (Member of the American Academy of Actuaries) designation and meets the applicable professional standards of the Academy. The qualified actuary must certify that actuarial items submitted comply with applicable regulations and Actuarial Standards of Practice in effect at the time of submission. The items to be submitted by the qualified actuary include but are not limited to the following:

- An annual statement of opinion on the adequacy of reserves
- An annual calculation of risk-based capital
- All product-related filings that require an actuarial certification
- Documentation requested by the Federal Insurance Regulator to demonstrate compliance with Actuarial Standards of Practice

It is our belief that including these components in any federally regulated insurance structure is essential to protecting insurance consumers and preserving the financial health of insurance companies.

APPENDIX A – The American Academy of Actuaries

The American Academy of Actuaries

The American Academy of Actuaries is the public policy and professionalism organization for actuaries practicing in all specialties within the United States.

A major purpose of the Academy is to act as the public information organization for the actuarial profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.

The Academy also develops and upholds actuarial standards of conduct, qualification and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

Academy Membership Requirements

The requirements for admission to membership in the Academy are set forth in Article I of the Bylaws and in these procedures.

The Academy Board of Directors, in accordance with Article I, Section 2(B) of the Bylaws, prescribes the following educational requirements for prospective members. An applicant who has attained the indicated status in one of the organizations listed below shall be deemed to have met the education requirements for admission to membership:

1. Associateship in the Casualty Actuarial Society or the Society of Actuaries.

2. M.S.P.A. or F.S.P.A. in the American Society of Pension Actuaries.

3. Membership in the Conference of Consulting Actuaries.

4. Fellowship in the Canadian Institute of Actuaries, the Faculty of Actuaries in Scotland, the Institute of Actuaries of Australia, and the Institute of Actuaries in Great Britain.

5. Enrolled Actuary status under Subtitle C of Title III of the Employee Retirement Income Security Act of 1974.

6. Membership in the Colegio Nacional de Actuarios. In those cases where familiarity with actuarial practices and principles in the United States cannot be assumed, the Executive Committee is empowered to call for evidence of such familiarity.

An applicant who has attained actuarial educational credentials other than those enumerated above may submit those credentials to the Academy for review and approval by the Membership Committee and the Executive Committee.

A. Applicants to the Academy must be of good moral character and have professional integrity. Evidence of the lack of good moral character or professional integrity shall be grounds for rejection of an application to membership in the Academy.

B. In those cases where good moral character and professional integrity cannot be assumed, the Membership Committee and Executive Committee are empowered to call for evidence of such good moral character and professional integrity.

An applicant must, at the date of application, have had at least three years of fulltime equivalent experience in responsible actuarial work. "Responsible actuarial work" is defined as work that has required knowledge and skill in solving practical actuarial problems in any of the fields identified in the Academy Bylaws. The following guidelines apply to experience:

A. At least one of the three years of responsible actuarial experience must fall within the five years preceding the date of application.

B. Teaching experience in actuarial courses may be considered for the three-year requirement. Non-actuarial-specific courses, such as probability and statistics, do not count as actuarial courses for this purpose.

C. Summer, part-time, and other intermittent experience may be considered for the three years of full-time equivalent experience.

D. Experience obtained outside the United States may be considered for the three-year requirement. An applicant who has practiced in any other field that is actuarially related may submit information about his or her field to the Academy for review and approval by the Membership Committee and the Executive Committee.

APPENDIX B – The Actuarial Standards Board

The Actuarial Standards Board (ASB) was established on July 1, 1988, as an independent entity managed with Academy staff support. The ASB has the authority to prescribe its own operating procedures; to establish committees, subcommittees, and task forces it may deem necessary in carrying out its assigned functions; and to appoint individuals to positions on such committees, subcommittees, and task forces. The operating committees report to the ASB and function under its direction. The ASB also has the authority to approve exposure of proposed standards and hold public hearings on them, and to adopt recommended standards of practice.

The ASB is charged with the following: (1) to direct and manage the development of actuarial standards of practice by its operating committees in all areas of actuarial practice; (2) to expose, promulgate or adopt, and publish actuarial standards of practice, within its sole discretion and pursuant to such procedures as it deems appropriate, in all areas of actuarial practice; and (3) to provide continuous review of existing standards of practice and determine whether they are in need of amendment, alteration, expansion, or elimination.

APPENDIX C – The Actuarial Board for Counseling and Discipline

The Actuarial Board for Counseling and Discipline (ABCD) was formed to serve the five U.S.-based organizations representing actuaries. The ABCD considers complaints and questions concerning possible violations of the Code of Professional Conduct.

Organizations served by the ABCD include the Academy, the American Society of Pension Actuaries, the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries. The ABCD also serves the Canadian Institute of Actuaries relative to practice by its members in the United States.

In addition, the ABCD responds to inquiries by actuaries concerning their professional conduct and, when requested to do so, provides guidance in professional matters.

The ABCD's members represent all main areas of actuarial practice and all U.S. organizations representing actuaries. A selection committee composed of the presidents and presidents-elect of the U.S. organizations appoints ABCD members.

The ABCD was established effective Jan. 1, 1992, as an independent entity administered with Academy staff support.

Upon delegation of appropriate authority from a participating actuarial organization and acceptance of that delegation by the ABCD, the ABCD is authorized:

1. to consider all complaints or information suggesting possible violations of the applicable Code(s) of Professional Conduct and all questions that may arise as to the conduct of a member of a participating actuarial organization in the member's relationship to the organization or its members, or in the member's professional practice, or affecting the interests of the actuarial profession;

2. to counsel actuaries concerning their professional activities related to the applicable Code(s) of Professional Conduct in situations where the ABCD deems counseling appropriate;

3. to recommend a disciplinary action with respect to an actuary to any participating organization of which that actuary is a member;

4. to respond to requests for guidance regarding professionalism from members of the participating organizations; and

5. to mediate issues between members of participating actuarial organizations, or between such members and the public, for the purpose of informally resolving issues concerning the professional conduct of such members.

APPENDIX D – Other U. S. –Based Actuarial Organizations

There are four other U.S.-based actuarial organizations that provide services to actuaries. These organizations address specific areas of interest or need to actuaries in their area of specialization. These organizations are The American Society of Pension Actuaries (ASPA), The Casualty Actuarial Society (CAS), the Conference of Consulting Actuaries (CCA), and the Society of Actuaries (SOA). The primary purpose of each of these organizations is described below.

The American Society of Pension Actuaries (ASPA)

ASPA is a national organization of retirement benefits professionals. The purpose of ASPA is to educate pension actuaries, consultants, administrators and other benefits professionals, and to preserve and enhance the private pension system as part of the development of a cohesive and coherent national retirement income policy. Although ASPA was founded in 1966 as an actuarial organization, the growing needs of the pension community led to the expansion of our membership to include pension professionals of all types: consultants, administrators, accountants, attorneys, chartered life underwriters, and more.

The Casualty Actuary Society (CAS)

The Casualty Actuarial Society is a professional organization whose purpose is the advancement of the body of knowledge of actuarial science applied to property, casualty, and similar risk exposures. This is accomplished through communicating with the publics affected by insurance as well as presenting and discussing papers, attending seminars and workshops, conducting research, and maintaining a comprehensive library collection. Other important objectives for the Society are establishing and maintaining high standards of conduct and competence for its membership through study and a course of rigorous examinations, developing industry standards and a code of professional conduct, and increasing the awareness of actuarial science.

The Conference of Consulting Actuaries (CCA)

The Conference of Consulting Actuaries advances the practice of actuarial consulting by serving the needs of consulting actuaries and by promoting members' views within the actuarial profession. This is accomplished by providing educational forums for consulting actuaries to enhance their skills, ensuring members are represented in issues affecting their practices and clients, and promoting and enforcing professional standards. The Conference of Consulting Actuaries strengthens both the practice of actuarial consulting and the ability of its members to better serve their clients and the public.

The Society of Actuaries (SOA)

The Society of Actuaries is an educational, research, and professional organization for actuaries in the United States and Canada. The Society's mission is to advance actuarial knowledge and to enhance the ability of actuaries to provide expert advice and relevant solutions for financial, business, and societal problems involving uncertain future events. The vision of the Society of Actuaries is for actuaries to be recognized as the leading professionals in the modeling and management of financial risk and contingent events.

APPENDIX E – Actuarial Training

The actuarial profession employs over 14,000 individuals. Actuaries are essential to the measurement and management of risk in financial security programs. Actuaries are involved in assessing risk, designing insurance programs, establishing prices for these programs, and ensuring that these plans are maintained on a sound financial basis. Actuaries make use of a broad knowledge of business, economics, finance, mathematics, and statistics to analyze the risks related to various contingencies and perils.

Most actuaries are employed in the insurance industry, for insurance companies, health care organizations, consulting firms, or regulatory agencies. Actuaries are also employed in other non-insurance financial services institutions such as banks and securities firms as well as for the federal government (e.g. the Centers for Medicare and Medicaid Services, General Accounting Office, Pension Benefit Guaranty Corporation, Railroad Retirement Board, and Social Security Administration). Actuaries will generally specialize in a particular insurance segment such as property/casualty or life or health insurance, or pension benefits.

Regardless of specialty, actuaries assemble and analyze data to estimate probabilities of an event taking place, such as death, sickness, injury, disability, or property loss. They also address financial questions, including those involving the level of pension contributions required to produce a certain retirement income level or how a company should invest resources to maximize return on investment in light of potential risk. In addition, actuaries are involved in setting company policy and insurance regulations and are called upon to explain complex technical matters to company executives, government officials, shareholders, policyholders, or the public in general. Using this broad experience and knowledge base, actuaries are often heavily involved in the development of plans to enter into new lines of business or new geographic markets with existing lines of business by forecasting the financial impact under various scenarios.

Actuaries need a strong background in topics such as mathematics, economics, statistics, and finance. An undergraduate degree in one of these areas is typically the start of the academic training for an actuary. In addition, a rigorous examination process is required to obtain professional designation in the actuarial profession. The successful completion of this examination process has often been compared to obtaining a doctorate or PhD in mathematics or finance. The Society of Actuaries (SOA) and the Casualty Actuarial Society (CAS) sponsor the examinations. Completion of the examination process through the SOA would result in a Fellow, Society of Actuaries (FSA) designation and completion of the examinations through the CAS would result in the Fellow, Casualty Actuarial Society (FCAS) designation. Generally, individuals who achieve an FSA designation work with life, health or pension product lines and an individual with an FCAS would generally work with property and casualty and health coverages.

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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

STATEMENT BY

THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

ON REFORMING INSURANCE REGULATION—MAKING THE MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

SUBMITTED TO THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

NOVEMBER 5, 2003

INTRODUCTION

Mr. Chairman, members of the committee, the National Association of Mutual Insurance Companies (NAMIC) is pleased to submit this statement for your consideration on the matter of reforming insurance regulation to make the marketplace more competitive for consumers.

NAMIC is the nation's largest property/casualty insurance trade association with 1,350 members that underwrite more than 40 percent of the p/c insurance premium written in the United States. NAMIC's membership includes 4 of the 7 largest p/c carriers, every size regional and national insurer and hundreds of farm mutual insurance companies.

NAMIC welcomes this hearing. Making the insurance marketplace more competitive is our paramount objective. The liberalization of laws restricting insurers from operating freely within the marketplace will benefit consumers in the form of lower prices and greater selection of insurance products.

However, NAMIC member companies believe that greater competition is best achieved within a state regulatory system reformed by state legislatures and state regulators rather than by the Congress. Federal regulation of insurance is unproven and, in our view, a politically uncertain proposition. Artificial barriers to competition and regulations that vary from state to state without serving any public purpose should be and are being addressed by the states.

Achieving reform of state insurance regulation is our highest public policy priority and every year we devote a larger percentage of our resources to this objective. Given the profile of our membership, NAMIC's position is representative of a dynamic cross section of the property/casualty insurance industry.

Nonetheless, we support this level of inquiry because we believe that indications of an interest in insurance regulation by the Congress will motivate state policymakers to act.

THE ROAD TO REFORM FROM THE NAMIC PERSPECTIVE

In 2002, NAMIC released a public policy paper articulating our proposal for a reformed system of state regulation and our arguments against the federal regulation of insurance. Entitled ***Regulation of Property/Casualty Insurance: The Road to Reform,*** it is the culmination of years of member study. Our member companies began their consideration with an open mind, but as work progressed it became clear that the best option for consumers and the insurance industry is to reform the state system rather than coming to Congress for a solution that promises to be worse than the original problem.

The insurance industry is at a crossroads. Many in our industry already have chosen the path of reform that runs through Washington. They believe the state system of regulation

is irreparably broken and only can be fixed by Congressional action. Others take a wait and see approach to reforming the state system. Indeed, they are engaging in efforts of reform, but with one eye on the clock, almost waiting to jump on the bandwagon making the most progress.

A Reformed System of State Insurance Regulation is Superior

Changes must be made by state legislatures to create a reformed, competitive and consistent system that will benefit consumers. NAMIC is working to achieve four specific areas for reform:

RATE REGULATION

States should eliminate the approval process for pricing insurance products. NAMIC has endorsed the NCOIL Property/Casualty Modernization Act approved in 2001. The model lays out a "use and file" regime for personal lines in competitive markets and a "no file" standard for commercial lines. There is unanimous support among the industry trades for this language.

Still, this is a potentially controversial issue among some state legislators. However, rate modernization not only is not radical, it is not new. Two brief examples speak to its success as public policy:

- In 1969, the **Illinois** legislature repealed outright the prior approval law that was put in place following passage of McCarran-Ferguson in 1945. Property/casualty rates in Illinois remain unregulated today. Several vital signs demonstrate that this policy works well. Today, consumers enjoy stable rates, ranking in the middle of all states in average personal expenditures because the Illinois market attracts the largest share of all private passenger auto and homeowner insurers in the nation. Low residual markets indicate affordability and availability. These positive signs are all the more remarkable when you consider that Illinois includes the third largest urban area in the United States, and two-thirds of the state's residents live in the Chicago area. With over three decades of success and no legislative proposals to reinstitute regulation, there can be no argument that this structure is well tested and beneficial to everyone involved.

- The demonstrably negative impact of prior approval on **South Carolina**'s state auto insurance market prompted the Legislature to act in 1999. Only 78 companies offered policies in the state in 1996 and over 40 percent of all insured drivers were in the assigned risk pool. With the elimination of prior approval in favor of a flex rating system, 105 new companies are in the market, rates are lower and residual market participants, once numbering over a million, have declined to 58,000.

Recent progress demonstrates that states are beginning to take responsibility for the negative results of their regulatory policies. **New Jersey** and **Louisiana**, two of the most

restrictively regulated states in the nation, have begun to overhaul their public policies regarding rate regulation in the face of shrinking pools of insurance providers.

As has been often and loudly stated, the product approval process is especially challenging for the life industry because of direct competition with banks in certain financial services. NAMIC agrees that the life industry and its consumers would be well served by a streamlined regulatory process and believe the life compact could help address this need. Efforts to create a more competitive marketplace for insurers and consumers alike must not begin and end on the life side of the equation.

MARKET SURVEILLANCE

States vary widely in how they staff and approach their market surveillance activities. A few states, for example, regularly schedule market conduct exams, regardless of whether problems have been reported with a particular insurer. The open-ended costs of these exams (salaries, meals and lodging) are charged to the company under examination. A lack of uniformity and coordination among states in performing exams often results in duplicative and costly processes, especially for multi-state insurers, who are most likely to be targeted for review.

As state insurance departments spend less time on "front end" regulation (i.e. prior approval), states need to adopt a market regulation program that relies on analysis of existing and available market data to reveal performance deviations rather than largely open-ended market conduct examinations relied upon today. With this approach, regulators can focus their limited resources on companies that fall outside a predetermined set of standards developed from data analysis. Any new market regulation process must be proportional, allowing insurers to mitigate complaints or market inconsistencies before being subjected to more severe actions like a market conduct exam, administrative penalty or fine.

SOLVENCY MONITORING

State regulators have adopted several solvency tools over the past decade to strengthen oversight of the insurance industry. While the industry has supported improvements in solvency monitoring, there remains a high degree of variation among states in how financial exams are conducted. NAMIC has helped produce an industry white paper that identifies three primary recommendations to facilitate discussion of the examination system by all stakeholders. Recommendations under consideration by the NAIC center on controlling expenses, integration of private CPA auditor work and risk-oriented financial reporting.

COMPANY LICENSING

States, working through the NAIC, have made some progress in the past few years in bringing more uniformity to the company licensing process. One outcome is the Uniform Certificate of Authority Application (UCAA), which is now used in all insurance jurisdictions. The states should now consider draft language so future amendments to the UCAA can be adopted without

seeking legislative approval each time. However, the key to more uniformity of this process is ensuring that state deviations are reduced or

We are pleased that the committee is not considering the imposition of a federal regulatory structure at this time. NAMIC encourages your continued resistance to that approach. We also encourage you to move cautiously down the path of federal involvement. It is this point NAMIC emphasizes based on the following reasons:

Federal Involvement is the Wrong Answer

In developing our public policy paper, NAMIC identified a series of defects in the rationale for seeking federal involvement in the regulation of insurance. They include:

1. **Federal involvement is often used to enact social regulation**. Under a federal system, insurance is likely to be treated as another "government entitlement" with all the trappings associated with that term. This would cause serious erosion to the basic principles of risk sharing upon which the industry is built.

2. **Asking Congress to intercede is fraught with danger for consumers and industry.** Proponents of federal regulation may design their idea of "a perfect system," but they can neither anticipate nor prevent the imposition of social regulation in exchange for the new regulatory structure. In our judgment, the chances of the "perfect system" going from draft legislation into law are almost nil.

3. **A federal or dual charter not only would not reduce regulation, it would add regulatory layers and complexity to the current system**. It is by no means certain that a new federal regulator would be the "single" regulator for even the largest property/casualty insurance companies. Dual regulation, proposed by some, would produce an unfair environment for the thousands of smaller companies, and create regulatory competition that often produces poor policy in financial institution regulation.

4. **Costs and bureaucracy will increase under a federal framework.** Will a federal charter reduce regulatory costs that are indirectly paid by consumers and/or taxpayers, and will it bring about less bureaucracy for companies choosing this option? There is no evidence that a federal insurance regulator is going to depart from the tradition of creating an expensive and inefficient government program. In addition, each state has its own unique tort laws that significantly affect insurance. Because state tort laws do not constitute the regulation of insurance, and have historically been shown great deference by the courts, federally licensed insurers would have to tailor products to accommodate each state's tort laws. These factors will significantly hamper gaining efficiencies from a federal system.

The cost to consumers will inevitably rise as well. Currently, states derive significant income from premium taxes, which exceed the cost of regulation. The cost of a new layer of federal regulation must be accounted for somehow. The necessary funds must either come directly from the federal budget, or from fees assessed to insurers. Since

taxes and fees must be passed on to consumers, they will have to pay for two regulatory systems under a dual charter approach, unless the states forego premium tax revenue.

5. **When the single national regulator makes a mistake, it has significant economy-wide consequences.** When a state regulator makes a mistake, the damage is localized and can be more easily "fixed." In other words, what if a national regulator gets it wrong? Industry proponents argue that Congressional action could produce a national system resembling the open competition found in Illinois – a regulatory model that NAMIC strongly supports. But what if the system created looks more like highly regulated states? The economic fallout from a strict national regulatory climate would be crippling, and the accountability would be at Congress' door.

6. **The time for further change has not arrived.** The new balance necessitated by GLBA is still evolving. It has shown great promise, but requires more time to mature fully. Unlike 1999 when GLBA passed, there is no major impetus, such as convergence of the financial services industry, to further change the balance between federal and state regulation. In times past, momentous change has been the consequence of significant needs or events. No such need exists today. Change without need could destabilize a system that has worked well throughout our nation's history.

State Regulation is More Pro-Consumer

From a consumer's perspective, the state system of regulation has performed admirably. It has proven to be adaptable, accessible, and relatively efficient, with rare insolvencies and no taxpayer bailouts. Proposals for federal and dual charters offer few advantages for consumers, and consumer interests are rarely cited as reasons for changing from the state system.

Federal regulation is no better than state regulation in addressing market failures or consumer interests. Regulated industries of all types have had failures at both regulatory levels. Neither can claim immunity from market failure. Additionally, claims that consumers are well served by federal bureaucracies seem dubious.

The clear advantage to consumers in the state system is accessibility. It is easier for an insurance consumer to deal with a regulator in their home state than having to contact a regional federal office to intervene in disputes.

WHAT COULD GO WRONG WITH FEDERAL REGULATION: S. 1373--THE INSURANCE CONSUMER PROTECTION ACT

One bill pending before Congress is S. 1373, The Insurance Consumer Protection Act. In our analysis, the legislation brings to life many of the concerns we have about federal regulation and should serve as case study for the potential damage that could be done by a federal regulatory proposal that is overly broad.

Government approval of insurance prices. S. 1373 is an anti-competition bill in that would require prior approval for all rates by a federal regulator. Not only is competition a much better regulator of rates than government, regulators in states with prior approval are routinely backlogged in their reviews. One super-agency is unlikely to be capable of staying current with rate applications. The result will be the imposition of needless bureaucracy and less efficiency with national implications.

Massachusetts' repressive auto rating structure provides living proof that restrictive regulation is unnecessary and harmful to insurers and consumers alike. In Massachusetts, the Insurance Commissioner is charged with setting every aspect of the auto insurance rate, even including the amount of money that an insurer may allot to expenses. This rate applies to all companies doing business in Massachusetts, which gives large national insurers who enjoy economies of scale a distinct advantage over smaller insurers. Despite this advantage, these insurers avoid this state. Massachusetts' auto insurance market is in a severe state of decline. Currently, there are less than 20 companies writing auto insurance in the state, while NAIC statistics show that their auto insurance rates are some of the most expensive in the nation.

On May 16, 2003, the Massachusetts Commissioner of Insurance held an annual hearing to determine whether competition existed in their auto insurance market. Had she found in the affirmative, she would not be obligated by state law to set rates as described above. This hearing, which was widely attended by the insurance industry, proved that regional and national insurers would like to re-enter this market. However, they will not do so until this punitive regulatory environment is reformed – a change that has been made by other states.

The number of insurers who compete in the competitive Illinois market is at least 6 times the number who seeks to survive in Massachusetts. In today's world, harmful regulatory structure has an impact beyond state borders. Many regional and national companies have simply decided that it is too costly to contend with this regulatory relic, so they avoid the state altogether, denying choices to consumers and removing incentives for companies to lower rates. True reform will result in the elimination of unnecessary regulatory burdens.

This proposal promises to slow regulatory processes even more through a provision that would allow anyone to challenge a rate filing. This is a serious flaw, particularly in the absence of provisions prohibiting frivolous or malicious objections. While consumers do not want to pay higher insurance rates, they also want to their insurance carrier to be solvent. Ideally, premium decisions should be based on adequacy of the rate and competitive pressure – not political pressure. Subjecting the critical calculation of ratemaking to a political process, as this provision would, will harm not help consumers by creating a supercharged environment in which defending rates that are actuarially sound will be needlessly difficult. This is the kind of "social regulation" that will ultimately harm this industry's ability to charge a price based on risk.

Increased market conduct burdens. This proposal dramatically increases the use of market conduct examinations. While regulators and industry agree that this can be a useful regulatory tool, the way in which exams are triggered and conducted is already under an extraordinary level of scrutiny. Currently, the states that conduct these exams do so on a scheduled basis – regardless of the company. The result is that a company on solid footing may face an intensive review, while the bad actor next door knows that they won't be subject to an exam for another 3 or 4 years. Even when bad actors are revealed, regulatory resources will be spread so thin that dealing aggressively with the problem may not be possible. This proposal would radically increase the indiscriminate use of this tool at a time when there is a growing consensus that a more thoughtful, and perhaps targeted, approach is more desirable.

A far more constructive use of regulatory resources is to focus on identifying and intervening in problem situations. Systems to facilitate this more effective form of regulation are currently under consideration. Diverting resources away from identifying and addressing problems in their earliest possible phases can only harm the cause of responsible regulation. Not only would this result in needless use of public and private resources, but also it would be a mistake felt nationally.

Destabilized state guaranty funds. State guaranty funds are one of this industry's greatest consumer protection stories. Their creation and continued success provides further proof of this industry's ability to adapt to the needs of the times. By removing all federally licensed insurers from state guaranty funds, this proposal would leave the viability of the state guaranty funds in question. It is unclear whether the remaining local companies in each state would have sufficient resources to protect consumers whose insurers become insolvent. Once again, this mistake will result in needless bureaucratic duplication, and will be felt on a national basis.

A related and troubling aspect of this proposed legislation would create a federal guaranty fund system, and protect its officers from personal responsibility, "for any act or omission". This provision is particularly curious in light of the heightened corporate governance provisions in this Act. While CEOs of insurance companies would be required to personally attest to portions of their annual reports, guaranty fund officials are given civil immunity for "any act or omission". This inequity is compounded by what can only be described as the Act's victim-pays provision. If insurers are victims of official misconduct, they will be forced to fund their own compensation for damages, in that repayment will come from the guaranty fund.

Suspect uniformity. One of the few advantages that could potentially be offered by federal regulation is a degree of uniformity by eliminating unnecessary regulation. However, this proposed legislation would not provide uniformity because it subjects federally licensed insurers to state regulations that are more stringent than the federal standards.

Not all differences between the states are unnecessary, but reflect unique conditions in each state. For instance, the states are prone to a diverse series of risks that inevitably

result in different regulatory requirements. Those risks include: earthquakes, floods, draught, forest fires, hail, tornadoes and hurricanes. The p/c industry provides insurance for natural disasters, and our products must vary to address the particular situation in each region. When it comes to these kinds of differences, one size does not fit all, and a government-sponsored incentive in one area would make no sense in another. These variations will continue regardless of the regulatory structure.

Tort laws will also continue to vary by state. Because tort laws do not appear to constitute the regulation of insurance, and have historically been shown deference by the US Supreme Court, a federal insurance regulator would not have the authority to create tort uniformity.

Even the sponsor of S. 1373 recognizes the primacy of state law, in the aforementioned provision that subjects federally regulated insurers to state standards that are more restrictive than the federal standards, unless the state standard prohibits something authorized by the federal law.

New bureaucracy. It creates a new regulatory bureaucracy, while leaving state systems and premium taxes in place. It is commendable that this proposal does not seek to deny states much needed premium tax revenues in these difficult fiscal times. However, the result will be that policyholders would have to fund two regulatory structures. This is particularly troubling in light of the fact that state systems have a proven ability to adapt to the needs of the times.

ACCOUNTABILITY FOR REGULATORY REFORM

Calls for reform of the state insurance regulatory system have been heard for years but little substantive reform, other than the NAIC financial accreditation program, has occurred. Frustrations have grown as the marketplace becomes more competitive and more global. Complicating matters further is that the NAIC is often --wrongly in our view -- held solely to account for implementation of sweeping reform.

The NAIC is just one piece of the reform puzzle. Public policies defining reform must be established by state legislatures. Yet the NAIC has been looked to for years by Congress and others as the source of regulatory reform.

However, in our judgment this is incongruent with reality. In describing its own work, the NAIC has said that regulators have long realized that diversity and experimentation are strengths of the state system, but they also recognize that the basic legislative structure of insurance regulation requires some degree of uniformity throughout the states. This inherent tension between sovereignty and uniformity in the context of a voluntary organization of mostly appointed state officials with no authority to enact the models they write has produced both large expectations and large disappointments.

NAMIC is pleased that this committee recognizes these limitations and has invited representatives from the National Conference of State Legislatures (NCSL) and the National Conference of Insurance Legislators (NCOIL) to participate side-by-side with the NAIC at this hearing. NAIC is likely pleased as well in that the three organizations have forged a historic alliance for the purpose of reforming state regulation. The NAIC deserves recognition for focusing attention on key marketplace improvements such as speed-to-market and market conduct for which NAMIC member-companies are asking.

While individual state regulators can recommend standards for reform and raise the profile of important market reform issues, they cannot act alone. Simply put: the NAIC cannot be expected to do what it is not empowered to do, that which is the most pressing task for all of us concerned about the future of the insurance industry: enactment of fundamental public policy reform.

In the final analysis, before Congress intercedes, state legislative action must be the focus of modernization initiatives. There is accountability for the future of state regulation and it rests with the three organizations that make up your first panel.

CONCLUSION

NAMIC is asking for fundamental reform of insurance regulation. Competition must be enhanced and unnecessary regulatory barriers between the states must be eliminated. True reform must also preserve the meaningful differences between the states. This balance can best be achieved through reforms within the states.

History has proven that state insurance regulation can be reformed through emphasis on state legislatures. In taking this stance, we are not relying solely on history. Significant changes are currently underway within the states. These changes are happening with the cooperation, assistance, and advocacy of the insurance industry.

At the same time, we are deeply concerned about calls for federal regulation of insurance. After extensive study, NAMIC has determined that federal regulation of insurance was undesirable because:

1. It is likely that social regulation would be employed, harming the industry's ability to price risk.

2. There is no guarantee that proven free market reforms would be employed.

3. Any system of dual regulation would add a layer of bureaucracy and cost that would ultimately be paid by policyholders.

4. Regulatory mistakes will not be contained within a single state, but will have an immediate national impact.

When we first articulated these concerns, some argued that they were only theoretical. However, with the introduction of S 1373, the Insurance Consumer Protection Act of 2003, many, if not all of our concerns have been justified.

The areas for reform have been defined. Now it is up to the states to enact changes in public policy that will make the difference. We urge you to continue your efforts to assure that change takes place in the states. As it has in the past, your interest alone will prompt a renewed resolve on the part of the states. We believe this pressure, given time, will bear fruit.

Thank you for your consideration of our comments.

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