THE NEED FOR INSURANCE REGULATORY REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

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THE NEED FOR INSURANCE REGULATORY REFORM

Wednesday, October 3, 2007

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 notice, at 2:37 p.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Sherman, Moore of Kansas, Scott, Bean, Hodes; Pryce, Hensarling, Baker, Shays, Manzullo, Royce, Capito, Garrett, Gerlach, Davis of Kentucky, Roskam, and Marchant.

Ex officio: Representative Bachus.

Also present: Representatives Pomeroy and Fossella.

Chairman Kanjorski. The hearing of the subcommittee will come to order.

I ask unanimous consent that Mr. Pomeroy and Mr. Fossella be permitted to participate in today's hearing. Without objection, it is so ordered. Also, without objection, all members' opening statements will be made a part of the record.

We meet this afternoon to review and discuss the need for insurance regulatory reform. Now that we have completed our initial work in the House on extending the Terrorism Risk Insurance Act for a second time, I am pleased that we can finally turn our attention to another important insurance issue.

This hearing is the first in a series that we will convene on insurance regulatory matters during the 110th Congress. Although we have already reviewed this topic in a variety of ways during about two dozen hearings since the start of the decade, approximately one-third of the members joined the Capital Markets Subcommittee this year. This hearing, therefore, will give them an opportunity to begin to learn the issues. It will also provide veterans of our panel with a fresh look at these matters.

The vast majority of interested parties in the debate on insurance regulatory modernization, myself included, agree that there is no longer a question of whether or not to pursue reform. The question we must answer is how best to achieve this reform. To do so, we must start at the beginning and establish in this Congress a better appreciation of the industry's needs, a clearer understanding of recent developments in the domestic insurance marketplace and world stage, and an enhanced awareness of the policy underpinnings of the industry's existing regulatory structure. A careful examination of these points will help to lay the groundwork for any decision that the Capital Markets Subcommittee will make in the future.

On this point, I want to explain, briefly, my plan for the process by which we ought to proceed to consider insurance regulatory reform. Today, we will hear from a number of key participants in the insurance industry, including the regulators, on the need for regulatory modernization. In their oral testimony, I hope that our witnesses will confine their remarks to their experiences in the current system and to any new developments in the insurance industry. I am also curious to know if any recent changes point in favor of or against pursuing certain regulatory reforms.

Because many others asked to testify today, we will hear additional perspectives on the need for reform in a subsequent hearing or in future hearings. This issue is important and complicated. The imposition of the Federal Government in some form into an area traditionally regulated by the States has enormous implications for insurers, businesses, and consumers. Therefore, we should not rush into considering reform legislation.

After establishing a need for reform, we will begin to explore policy options for reform. During these hearings, we will hear from a number of stakeholders representing a variety of views on generic reform options. Additionally, we will almost certainly convene separate hearings at some point on discrete issues like solvency protections, enforcement systems, product approval, and best practices for reform implementation.

Before moving to finalize any legislation, I would additionally envision that we will create bipartisan, member-driven task forces to study targeted issues related to insurance regulatory reform and will put together recommendations for a bill. These task forces should help us to reach a consensus. I invite my colleagues to let me know of their interest in leading and serving on these task forces.

With a solid understanding of these complex issues, this subcommittee, and eventually the U.S. Congress, can make meaningful, well-thought-out reforms. This process is not a sprint. We need to review these issues and the potential consequences of changes to the industry, consumers, business, and the general public.

Let me be clear: I have no battle plan, no ax to grind, and am open to considering all points of view. I may have inclinations toward pursuing certain reforms, but I have made no final decisions about how to implement such reforms and how to build a broad consensus that garners the support of many, not just a slim majority. I plan to work through the issues step-by-step.

In reviewing the testimony of our witnesses today, I know they all hold strong opinions on which reforms might best accomplish their particular goals or undermine their perceived competitive advantages. American businesses and families rely on insurance daily. It is our job in Congress to balance the need of consumers to have the most innovative and worthwhile insurance products on the market against the economic stability and efficiency of the insurance markets.

In closing, I am optimistic that through careful deliberation and hard work, we can identify a genuine consensus about how best to achieve regulatory reform in the insurance marketplace.

I am also appreciative of the work of my ranking Republican member, who joined me in sending out the invitations to our witnesses. It is my hope that bipartisanship will continue to guide our work in this area in the months ahead. I also look forward to an opening dialogue today.

The gentlelady from Ohio, Ms. Pryce.

Ms. PRYCE. Thank you very much, Mr. Chairman.

I would like to start by relating a story retold in the National Association of Insurance Commissioners' 1995 annual report. It describes a fascinating scenario.

It is the story of the very first NAIC meeting, described as "remarkable in its harmony." The New York superintendent of insurance and the founder of the NAIC, George Miller, told the Baltimore underwriter, "The commissioners are now fully prepared to go before their various legislative committees with recommendations for a system of insurance law which shall be the same in all States, not reciprocal, but identical. The companies and the public will both be largely benefited." That was in 1871.

And 126 years later, in the 1980's and 1990's, the Democratic-controlled Congress, still looking at this, criticized promises by the States and the NAIC to modernize the insurance regulatory system, issuing reports entitled "Failed Promises" and "Wishful Thinking."

In 2000, the NAIC appeared before this committee and promised the Congress uniformity in their statement of intent on modernization. In 2001, product review uniformity was sought through CARFRA. In 2002, the NAIC president said that CARFRA was being replaced by the Interstate Compact.

Finally, in 2003, after the GAO issued a major critique of States' lack of coordination and market conduct oversight, the NAIC announced that the collective action problem was too great a challenge to overcome, and they would likely be unable to meet it.

Six years ago, at yet another hearing, Chairman Oxley asked the NAIC representatives, "If Congress sets a goal of 3 to 4 years for achieving comprehensive uniformity by NAIC for product approval, do you feel confident you can meet the goal?" The response was that, "The current system is not good for consumers. The goal must be met, and if it is not met, then there needs to be questions raised about whether the States can solve the problems identified." Six years have passed, and it is clear that the problems cannot be solved by the States alone.

Where progress has occurred, it has been largely because of Federal pressure. For example, the achievement of uniform solvency standards and reciprocal agent licensing standards has been pursuant to congressional mandates or threats. And consumers have been well-served by the Risk Retention Act that was passed in 1981 to allow liability consumers to form their own self-insurance underwriting and purchasing groups. We have also seen progress with Gramm-Leach-Bliley and, hopefully, TRIA. Targeted reforms work. In the banking industry, the optional Federal charter has worked. These are not mutually exclusive efforts.

I will be introducing legislation later this year with some of my Democratic colleagues to expand risk retention to allow businesses to band together to address their property as well as their liability insurance needs. This effort is supported by universities, hospitals, health-care providers and numerous other groups, and it is another example of how Congress can act to create more options and more uniformity without requiring additional Federal presence. We should also see if we can find the best aspects of the dual banking system and determine if or whether they should be applicable to insurance regulation.

Along with the chairman, I am open to any and all approaches that move us forward in reforming the market. We can all agree that serious concerns have been raised about the efficacy of the current regulatory framework. These are inefficiencies that are hurting consumers and stifling innovation. We do not need to count back to 1871. We have had over 15 hearings and roundtables on insurance reform in the last several years alone. The need is clear. The time to act is now.

I am ready to put my full energies into working with you, Mr. Chairman, and with the chairman and ranking member of the full committee on a package of reforms wherever we can achieve consensus and move the markets forward.

I appreciate your holding this hearing, and I look forward to the testimony with an open mind, in terms of reaching some consensus.

Thank you, sir.

Chairman KANJORSKI. Thank you, Ms. Pryce.

Mr. Sherman of California.

Mr. SHERMAN. Thank you, Mr. Chairman.

I think the gentlelady from Ohio has it right in her historical analysis, and that is, what uniformity we have gotten from the States has been as a result, often, of Federal pressure. And hopefully, this hearing will do the trick again, or the series of hearings, and perhaps we will not need legislation, but we do need a system by which products can be approved more quickly. And the standards for judging whether those products meet consumer needs need to be more uniform.

We have had throughout this country's history the State regulation of insurance. I am not eager to jump away from that, but I am also not eager to be listening to another round of complaints about how long it takes to get products approved, particularly in the life and annuity area.

Secondly, I would point out that, although on this panel I do not think we are hearing from the insurance agents—I am sure, with future panels, we will—I do not think any optional Federal charter or any of the other Federal reforms of which we are thinking will directly affect insurance agents. But they are important stakeholders, and more importantly, they are there on the ground, looking at the interests of consumers, and should be able to benefit us with their expertise.

If we do end up having to go with an optional Federal charter, we have to make sure that this is not a lowest-common-denominator charter. The whole idea of forum shopping or regulator selection or hopping has the feel of it that, well, companies will just go to whichever regulator gives them the best deal. We need to make sure that any optional Federal charter has very strong consumer protections. It does not need to be a collection of each of the most restrictive ideas any of the 50 States can come up with, but it also should not be a circumstance where a Federal regulatory agency views itself as competing for business by trying to serve its customers, namely, the individual insurance companies.

So I look forward to continued good consumer protection and, hopefully, to a faster process of approving new products.

I yield back.

Chairman KANJORSKI. The gentleman from Louisiana, Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman.

I certainly appreciate your continuing interest in this subject. I know you and I have spent many hours over the past years engaging in efforts to find some regulatory remedy for this most complex issue.

Of all of the sectors of the financial world, the insurance world is the one that enjoys the least or the lowest rate of return on equity. It has the most regulatory barriers, and it has the most significant challenges in the political and economic world today.

As an outgrowth of the Hurricane Katrina problem, the committee has already acted to pour the wind casualty insurance into the flood insurance program, which we all know is such an enormous success. We have passed recently a national catastrophe program for the State of Florida, which we are told will not adversely impact the taxpayers of the United States, but if you were to start out—for whatever reason I could not conceive—to start your own insurance company today and would want to sell that product nationally, you would have to go through 54 different, varying regulatory processes in order to have that product sold.

You would then be told that in some States you can use red paper, in others pink, in others green; some you staple, some you paper clip, while others you must sort individually. In some places, there are countersignatory requirements. In others, it is anyone's guess.

This is a mess, and we are moving, unfortunately, in the wrong direction in this session of the Congress to make matters worse, not better. It is clear academically, intellectually, and any kind of "ly" you want to apply to it, that the less we regulate industry and provide a more competitive environment, the more likely there is to be products offered at a better price to the consumer. Look at auto rates across this country, and look at where States act in the consumers' best interest and regulate everything that moves. We have fewer providers, higher rates, and more disgruntled automobile insureds.

The way for us to proceed is to find a way to lessen the regulatory burden, to allow people to innovate and, yes, even come to Louisiana and sell hurricane coverage if we allow free markets to function in a rational way.

Mr. Chairman, I know your thoughts on these matters. I know how hard you have worked in the past, and I really look forward to working with you to find the magic cure to this problem that has only taken us 40 years to examine.

Thank you.

Chairman KANJORSKI. Thank you, Mr. Baker.

The gentlelady from Illinois, Ms. Bean.

Ms. BEAN. Thank you, Chairman Kanjorski and Ranking Member Pryce, for holding today's hearing on insurance regulatory reform.

In addition, I would like to thank all of our distinguished panelists for sharing their expertise with us today.

I think it is safe to say that the members who serve on this committee would agree that America's preeminence in the economic world hinges upon the health of our capital markets and on our global leadership in the financial services industry.

Earlier this year, New York City Mayor Michael Bloomberg and U.S. Senator Charles Schumer commissioned a report on what changes were needed to keep the United States competitive in the global marketplace. One of the report's top recommendations was the creation of an optional Federal charter for insurance.

In July, Representative Royce and I introduced the National Insurance Act of 2007 to address issues of competitiveness and consumer choice. The bill would create an optional Federal charter for life and property-casualty insurers. Designed to emulate the regulatory structure found in the dual banking system, the NIA would give insurance providers the choice of being regulated at the State level or by the new Federal regulator. The bill gives consumers what they want: choice and protection. Insurance customers will have more pricing and product options, driven by a competitive marketplace freed from State price controls and regulatory hurdles, as Congressman Baker just alluded to. Consumer protection would be strengthened.

The current State-based regulatory system has hurt the U.S. insurance industry's ability to compete globally. In 2006 alone, the U.S. insurance services' trade deficit totaled $24 billion. The current system, which requires insurers to work with 51 different State regulators, is burdensome and slows the time to market for new products sometimes by years. This discourages insurance innovation and product development. A national charter would foster greater industry innovation and agility.

The insurance industry has changed and has evolved dramatically since 1871 when the National Association of Insurance Commissioners was established, but for 136 years, the regulatory system has not significantly changed. It is time to allow the insurance industry to move into the 21st century so we can more effectively compete on the global stage and provide more pricing and product options to our consumers.

As a resident of and as a representative for the State of Illinois, I have seen firsthand the benefits to consumer pricing and to product options in a deregulated environment. We can extend those benefits nationally with this bill. For years, hearings have been held identifying the problems inherent in the current system. Insurance reform needs to happen, and we should start now.

I look forward to your testimony and to your recommendations for how you feel we should proceed.

Thank you.

Chairman KANJORSKI. The gentleman from California, Mr. Royce.

Mr. ROYCE. Chairman Kanjorski, I thank you. I thank you also for holding this hearing and for your leadership on this issue.

I think that, you know, as to this hearing, which really focuses on some of the flaws in the current regulatory structure, an element of this is going to be looking at what the viable alternative is to this. And as Congresswoman Melissa Bean has just explained, she has introduced legislation, of which I am a cosponsor, but this is legislation that the Bloomberg-Schumer Commission and the U.S. Chamber Report on Competitiveness in the United States has recommended to us.

Why they have recommended this? Well, if we went back a few years, we would have seen that the financial center of the world, undisputedly, was New York. But now capital is a mouse click away, so if you have a situation in the United States where you have 51 separate markets and you are trying to do business in those markets and you watch as insurance out of London and out of Tokyo and out of Hong Kong—as you watch the competitive disadvantage that the United States is in and you watch the regulatory burden and the costs of bringing new products to market, which can take up to 2 years now, and the cost to the consumer, you begin to understand why this has become a concern for economists, for industry leaders, for Senator Schumer, for Mr. Bloomberg, and for those who want to see this remain the financial capital of the world.

Debbie Pryce is a former judge. She has a judicial temperament; she is patient. But as she says, she has sat through 15 hearings now as we have discussed the fact that we have been unable to get concurrence and agreement. And so these inefficiencies still remain across our system, this patchwork structure that we have, with 51 different regulators that are not consistent with world-class regulation. We need a world-class regulator.

And I believe the National Association of Insurance Commissioners has operated with the best of intentions. But, ladies and gentlemen, it has been 136 years. And these concerns are now concerns that have led so many prominent citizens and economists to ask us to look at this concept because it works so well in the banking industry, an optional Federal charter. And I think the American consumer has the most to gain.

Let me point out for you several subsets of our own constituents who have the most to gain—members of the Armed Forces, one-third of whom are relocated every year pursuant to Federal order. Every time they move—within days, they have to move, of notification—they keep their banks, they keep their investments, their securities, but regardless of where they are moved to, they have to start from scratch when it comes to insurance products. All of you who send children away to college start from scratch when it comes to insurance products.

The time and money spent whenever anybody relocates—and in addition, considering the compliance costs to our system of 51 State regulators, just for the ACLI, they did a little study on Federal regulation. What would the result be in compliance cost if there was one set of standards just for that segment of the industry? $5.7 billion annually. That is not including property-casualty insurers.

So, in a competitive market like the one which would be created under an optional Federal charter, those savings will undoubtedly be passed on to the consumer. In this ever-changing global marketplace, we have to have a world-class regulator able to properly regulate this critical industry, and an optional Federal charter is necessary to achieve this result, especially given the fact that, under the WTO, the E.U. and others are going to take action given this cumbersome, impossible situation we have and given the fact that our own industry now cannot get access and cannot get entry into markets worldwide on insurance products because of this cumbersome system that dates back 136 years here in the United States.

I yield back, Mr. Chairman. Thank you.

Chairman KANJORSKI. Thank you, Mr. Royce.

Now Mr. Scott of Georgia, by way of Scranton, Pennsylvania.

Mr. SCOTT. Absolutely, the great hometown of my distinguished chairman.

Let me just say, Mr. Chairman—first of all, let me thank you for having this very, very important hearing on insurance regulation. And let me thank the ranking member, of course, as well for holding the hearing.

I feel that this hearing is very timely, as the issue of insurance regulatory reform has certainly been a hot-button issue for some time now. Insurance regulatory reform is an issue many involved agree requires action; there is no question about that. However, it is evident that the approach to the concerns involved are certainly mixed at best, and that is why this hearing is so important, to hear the variety of concerns.

As the insurance industry continues to be primarily regulated at the State level and many involved wanting increased Federal oversight, I am interested to hear the views and concerns of our distinguished witnesses as we work toward some sort of consensus of our distinguished witnesses. I believe we all agree that regulatory reform is, indeed, necessary, but in any type of reform, it will take more time, discussion and compromise on how we move forward, because we want to take into account the actual operations of these businesses and how to ensure that whatever action we do take also does not deter competition, that it does not loosen efficiency or increase costs of operating. From the development of global markets to the various and detailed policy rationales toward pursuing regulatory reform, we must take all into account and listen to both sides of the issue before taking any further action.

There are some very, very critical questions that have to be answered. For example, how big will a national office of insurance need to be to handle the millions of consumer inquiries and complaints that State regulators receive each year? How big will that office be? Are there other Federal agencies that would be dealing with consumers that should be used as a model in this regard?

Now, one of the complaints of some in the industry is that it costs too much in compliance to introduce new products. We have to examine that. We have to give specific examples of new products that have not been introduced because of the cost of regulation as opposed to a business decision that a product is not competitive or profitable.

What assures that the marketplace will become no less competitive under a Federal regulator than it is currently under State regulation?

Finally, this question: Doesn't Congress have a duty to first use its significant influence, our resources, to try and help fix the current system before creating a brand-new competing system?

The insurance industry is vital. It is the cornerstone of our financial service industry, because in it is our safety net across the board. It is critical that these questions be examined and thoroughly answered so that we can effectively determine the best way to move forward on this very critical issue of insurance regulatory reform.

With that, Mr. Chairman, I yield back the balance of my time, and I look forward to the witnesses.

Chairman KANJORSKI. Thank you very much, Mr. Scott.

Well, now it is my pleasure to introduce our excellent panel:

The Honorable Walter Bell, the commissioner of the Alabama Department of Insurance and president of the National Association of Insurance Commissioners;

Mr. John Bykowski, president and chief executive officer of SECURA Insurance, testifying on behalf of the National Association of Mutual Insurance Companies;

Mr. Christopher M. Condron, chairman of the board and chief executive officer of AXA Equitable Life Insurance Company—and a former constituent of mine who is still very active in the Scranton, Pennsylvania area and with the University of Scranton—testifying on behalf of the American Council of Life Insurers;

Mr. Albert R. Counselman, president and chief executive officer of RCM&D, Incorporated, testifying on behalf of the Council of Insurance Agents and Brokers;

Mr. William H. McCartney, senior vice president of Insurance Regulatory Policy, USAA, testifying on behalf of the American Insurance Association; and

Mr. Alex Soto, president of InSource, Incorporated, testifying on behalf of the Independent Insurance Agents and Brokers of America.

Gentlemen, I welcome all of you.

I say "gentlemen," because there are no ladies, Deborah, but in the future, I am sure there will be.

Ms. PRYCE. We are trying.

Chairman KANJORSKI. Under the rules, we all have received your printed testimony. What I would ask you to do is to summarize within 5 minutes, if possible, your testimony so that we can get to the question-and-answer period. I will not be terribly strict with you, but if you push me to the wall, then I will become very strict, and I do not want to do that. But we look forward to your testimony, and then particularly to the responses in the question and answer period.

Mr. Bell?

STATEMENT OF THE HONORABLE WALTER BELL, COMMISSIONER, ALABAMA DEPARTMENT OF INSURANCE, AND PRESIDENT OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. BELL. Chairman Kanjorski, Ranking Member Pryce, and members of the subcommittee, thank you for inviting me to testify before you on the need for insurance regulatory reform.

As we examine our insurance system, we must take into consideration the needs of and the protection of all consumers.

As stated, my name is Walter Bell. I am the commissioner of insurance in Alabama and the president of the NAIC. I also serve as vice chair of the Executive Committee for the International Association of Insurance Supervisors, which is a group of 130 countries worldwide.

I am pleased to be here today on behalf of the NAIC to update you on our ongoing successful effort to improve the State system of insurance supervision. As has been stated, State insurance officials have served as a front line of U.S. insurance regulators for over 150 years. Our record of consumer protection and industry oversight is second to none in the world.

Insurance is a unique and complex product that is fundamentally different from other financial services, such as banking and securities. Most consumers find themselves concerned with the insurance coverage or lack thereof only in a time of crisis. State regulators have strengthened the State insurance regulatory process in any number of areas, including speed to market for product, rates and form filing, solvency, producer licensing, and fraud detection and prevention.

An ambitious speed-to-market initiative puts in place an interstate compact to develop uniform national product standards and to provide a central point of filing. The compact allows insurers to file new life insurance annuities and other wealth-protection insurance products and receive one, single, streamlined review.

Since the last time we talked about the compact before Congress, it has moved from concept to reality. To date, 30 States have implemented the compact, representing over 50 percent of the insurance market premiums nationwide. There has been a drastic reduction in the major insolvencies in recent decades. Regulators can now identify more quickly when insurers are troubled and can react more quickly to protect consumers.

In January 2005, the NAIC launched an online fraud-reporting mechanism. Consumers, employees, and others can now report wrongdoings to State enforcement authorities on a confidential basis. The SERFF program for electronic rate and form filings has been a huge success. Insurers choosing SERFF to file their products experience a much shorter turnaround time than under the traditional paper filing processes. Some SERFF filings are turned around in a single day. Currently, SERFF is being used by all jurisdictions and by over 3,000 insurance companies.

The next time someone tells you about an undocumented sob story about pink paper or paper clips from the decades past, tell them they need to leave the Pony Express behind and enter the Internet age.

State insurance officials remain deeply committed to achieving greater uniformity in the producer licensing process, demonstrated by the standard, uniform producer licensing application now used in every State. In addition, the NAIC has developed a uniform electronic system designed to help navigate State-specific requirements for State licenses to write insurance. Each State and in some cases even zip codes represent a distinct market, with varying risk, products, and price. Most of the Nation's 4 million insurance agents and brokers operate today in three or fewer States. Today, companies of various sizes sell on an unprecedented basis products across State lines on a national basis.

Some will tell you the world is changing, and we need to catch up to foreign countries. Let us put that argument to bed right here. When State insurance markets are compared to other national insurance markets around the globe, the size and scope of those States' markets and, therefore, the responsibilities of the States' regulators typically dwarf the markets of whole nations. Four of the top 10 and 26 of the top 50 insurance markets in the world are U.S. States. For example, Mr. Chairman, the insurance market in your home State of Pennsylvania is the twelfth-largest market in the world, larger than the insurance market of China.

Consumer protection demands that State insurance officials be ever-vigilant to respond to the changing needs of consumers, the industry, and the modern marketplace. We would urge careful analysis, as has been stated, of any proposal to achieve the modernization of insurance supervision through Federal legislation. Even well-intended and seemingly harmless Federal legislation can have a negative impact on existing State protections for insurance consumers. We respectfully request Congress, consumers and the insurance industry to work with us to continue to modernize what we have been doing to protect consumers.

Thank you very much for this opportunity today, and I look forward to your questions.

[The prepared statement of Mr. Bell can be found on page 58 of the appendix.]

Chairman KANJORSKI. Thank you, Mr. Bell.

Next, we will hear from Mr. Bykowski, the president and chief executive officer of SECURA Insurance, testifying on behalf of the National Association of Mutual Insurance Companies.

Mr. Bykowski?

STATEMENT OF JOHN BYKOWSKI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SECURA INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Mr. BYKOWSKI. Good afternoon, Chairman Kanjorski, Ranking Member Pryce, and members of the subcommittee.

My name is John Bykowski, and I am testifying today on behalf of the National Association of Mutual Insurance Companies. NAMIC is the Nation's largest P&C insurance company trade association, with more than 1,400 members.

I am the president and CEO of SECURA Insurance Companies, which are headquartered in Appleton, Wisconsin. Our company began in 1900, and we now write about $330 million in personal, commercial and farm products through 400 independent agencies in 13 States. And I currently serve as the chairman of NAMIC.

NAMIC appreciates the opportunity to testify today on this very important issue. NAMIC supports a reformed system of State regulation. While we agree with some of the criticisms you will hear today, ultimately, NAMIC believes reform at the State level is more likely to produce better results than further Federal involvement in the insurance industry. Let me explain why NAMIC and an overwhelming majority of property-casualty companies feel this way.

Since its inception, the U.S. property-casualty insurance industry has been regulated at the State level. NAMIC believes that State regulation has generally served consumers and insurers well over the years but that it has not kept pace with changing times. For example, long after other large national industries experienced sweeping deregulation, property-casualty insurance companies remained subject to some form of price controls in most States. That, more than anything else, must change. Other matters that deserve attention include the lack of uniformity among States' underwriting restrictions, blanket coverage mandates, and arbitrary and redundant market conduct examinations.

That said, NAMIC believes State insurance regulation has many strengths that are worth building upon. Chief among these are the ability of State departments to adapt to local market conditions, to experiment, to learn from each other, and to respond to the unique needs and concerns of consumers and insurers in their States.

Unlike banking and life insurance, property-casualty insurance is subject to local risk factors, such as weather conditions, tort law, medical costs, and building codes. State regulation is able to take account of these differences in ways that Federal regulation would not. Once more, because of their thorough knowledge of local conditions, State regulators are attuned to the needs and interests of each State's consumers, such as hurricane risks in Florida and Louisiana or earthquakes in California and Missouri. A distant Federal regulator would not have the ability to be as responsive to those same concerns.

Many States have made progress in recent years toward adopting needed reforms. They have softened company licensing restrictions, and in most cases, they have moved away from strict rate regulation. In fact, only 16 States still require prior approval of rates. Influential national organizations representing thousands of State legislatures have called for the abolition of prior approval rate regulation.

Federal intervention in insurance regulation could take several forms, ranging from a complete Federal takeover or to an OFC, such as embodied in H.R. 3200, or to the narrower Federal tools approach already pursued by the House Financial Services Committee in H.R. 1065, the Nonadmitted and Reinsurance Reform Act.

With respect to H.R. 3200, NAMIC believes an optional Federal charter would lead to negative outcomes that would far outweigh any potential benefits, and anticipated benefits would not be realized. Let me briefly outline our greatest concerns.

First, it is clear that Federal regulation has proven no better than State regulation at addressing market failures or in protecting consumer interests. Moreover, unlike State regulatory failures, Federal regulatory mistakes could have disastrous, economy-wide consequences. The Savings and Loan debacle is an example of what can happen.

NAMIC is also concerned that, while proponents of Federal regulation may design a "perfect system," they can neither anticipate nor prevent the imposition of disastrous social regulation at the Federal level. I quote "social regulation." I mean measures that tend to socialize insurance costs by spreading risk indiscriminately among risk classes. Regulations that restrict insurers' underwriting freedom often have this effect. Having the ability to accurately assess and classify the risks of loss associated with particular individuals and property is essential to the property-casualty insurance industry.

Proponents of H.R. 3200 like to point out that it is "optional," but NAMIC believes the choice offered by an optional Federal charter would prove illusory. The cost to a company from adopting a Federal charter is likely to be quite high, and switching back and forth would be impossible for smaller insurers. Most small insurers would be trapped in the regulatory system they initially chose. The result would be an unlevel playing field, since only the largest insurers would be able to afford the option of switching regulators, thus reducing competition in the market.

In conclusion, NAMIC believes that, while the States have not acted as rapidly or as thoroughly to modernize insurance regulation, they have picked up the pace of reform and appear headed in the right direction. Given this recent progress and the risks associated with creating an entirely new Federal regulatory structure, NAMIC is convinced that reform at the State level is the best and most appropriate course of action for consumers and insurers alike.

Thank you.

[The prepared statement of Mr. Bykowski can be found on page 80 of the appendix.]

Chairman KANJORSKI. Thank you.

Next we have Mr. Christopher Condron, the chairman and chief executive officer of AXA Equitable Life Insurance Company, testifying on behalf of the American Council of Life Insurers.

STATEMENT OF CHRISTOPHER M. CONDRON, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, AXA EQUITABLE LIFE INSURANCE COMPAN, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS

Mr. CONDRON. Thank you, Mr. Chairman. Thank you, Congresswoman Pryce and committee members. It is nice to be here this afternoon.

I am the CEO of AXA Financial and the chairman and CEO of our principal insurance operating subsidiary, the AXA Equitable Life Insurance Company.

AXA Equitable was founded in 1859 as the Equitable Life Insurance Society of the United States, and we became a member of the Global AXA Group 15 years ago. And today, the AXA Group is one of the world's three largest diversified insurance companies.

I am also a member of the Board of Directors of the American Council of Life Insurers. As the principal trade association for life insurance companies, the ACLI's 373-member companies represent 93 percent of the industry's overall assets.

The views I express today reflect not just my experience since 2001 while running AXA Equitable but also my prior experience as president and chief operating officer of Mellon Bank Corporation, now Bank of New York Mellon, and as the CEO of Dreyfus Corporation, the Bank of New York Mellon's mutual-fund subsidiary.

National banks like Mellon and mutual-fund companies like Dreyfus are principally regulated at the Federal level. The same holds true for most broker dealers. While that creates a significant competitive advantage, I am not here just to advocate fairer competition. I am here because the current archaic, State-based regulatory system is increasingly impairing our industry's ability to efficiently manufacture and deliver the kinds of products and services that your constituents and our customers so desperately need, products and services that insurers are uniquely qualified to manufacture and deliver.

For most of our 148-year history, our principal business was protecting people against the risk of dying too soon, but about 10 years ago, our business mix began to change. Increasingly today, our focus is protecting people against the risk of outliving their assets. We do that with variable annuities, which offer the benefits of investing in the capital markets while providing the peace of mind of downside guarantees.

Insurers hold the only franchise in the financial services industry that can guarantee Americans that they will not outlive their assets. As a result, we are uniquely positioned to help this Nation address the challenges posed by the aging of the 77 million baby boomers: longer lifespans; the increasing elimination of defined-benefit pension plans; and the low levels of retirement savings.

For us to continue to be a viable part of the solution to this Nation's challenges, however, the need to substantially overhaul the current State-based regulatory system is both urgent and critical. And while I am encouraged that we are making progress, I am concerned that we have not effectively explained the consequences of failing to move quickly.

And that may be due to just how well we have done as an industry in shielding our customers and you from what we face. Could you imagine the implications if the auto industry were regulated the way insurance is, by 50 separate States, with local regulators empowered to determine if cars sold in their States will be left-hand- or right-hand-drive, or when new models could come to market, or what safety features could be offered? Yet, that is exactly what we tolerate when it comes to insurance.

Our current system creates numerous regulatory gauntlets through which everything we do must pass: our product designs; the capital and reserving standards we must meet; how we administer our products; our sales practices; and the licensing standards for our agents. The result fractionalizes our business. It is common for us to have a dozen or more different versions of the same product in the marketplace at the same time.

There are States in which we can only sell a product that is three generations older than what we are allowed to sell in most of the rest of the country. And since an insurer's home State regulator gets to determine capital requirements for business done nationwide, it creates the potential for erratically disparate protections of consumers within the same State. This simply makes no sense and it is unfair.

At a time when most industries are increasingly looking to establish global regulatory standardization to deliver better value to customers, continuing to embrace this system does a disservice to all Americans.

Candidly, I was stunned at what I found when I joined this industry 6 years ago. At Dreyfus, I could get a new product to market in all States in less than 60 days with no variations. In insurance, it is closer to a year, and the product still will not be approved in all States, and even where it is, it has often been changed and, in some cases, fundamentally and substantially.

The stifling effect that this has on our ability to help solve America's retirement security crisis cannot be overstated. It also creates enormous headaches and inefficiencies for our agents, which, at AXA alone, number over 90,000. That is one reason why thousands of them have come out in favor of the Federal regulation through groups like Agents for Change, AALU and NAILBA.

A University of Georgia study recently estimated that the costs of this system are close to $6 billion a year more than if we had a single national regulator. And we all know who is paying for that.

While the costs should be of concern to all of us, there is something more important at stake, and that is our ability to use our unique franchise to help address the retirement security crisis our Nation is facing. That is in your hands.

We are not seeking easier regulation. We will gladly live with tough standards. What we are urgently seeking is the opportunity to choose uniformity in a single regulator.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Condron can be found on page 91 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Condron.

Our nest witness is Mr. Albert Counselman, the president and chief executive officer of RCM&D, Incorporated, testifying on behalf of the Council of Insurance Agents and Brokers.

Mr. Counselman?

STATEMENT OF ALBERT R. COUNSELMAN, CPCU, PRESIDENT AND CHIEF EXECUTIVE OFFICER, RCM&D, INC., ON BEHALF OF THE COUNCIL OF INSURANCE AGENTS & BROKERS

Mr. COUNSELMAN. Good afternoon, Chairman Kanjorski, Congresswoman Pryce, and Congressman Bachus. It is a pleasure to be here, representing the Council of Insurance Agents and Brokers.

My firm is the largest agency and brokerage firm in Maryland. We are agents, and we are also one of the 65 largest commercial insurance agencies and brokerage firms in the country.

In recent years, there has been a huge convergence in this sector of agents and brokers. Many of the problems we see in the fragmented State system are being exacerbated. The current regulatory structure is not equipped to handle an insurance marketplace that is international in scope. My firm serves clients in 50 States and in multiple countries, not unlike most council member firms, yet strikingly different from the local mode of operation that existed 20 or even 10 years ago. Like the marketplace, our clients have risks and exposures that transcend State boundaries. The current State regulatory patchwork cannot keep up due to the globalization of the business.

The Council is very grateful to Representatives Bean and Royce for introducing the National Insurance Act of 2007. The bottom line is that this bill provides real choice for all participants in the insurance marketplace. The critics of this bill often seem to forget that the Federal charter for agents, brokers, insurers and reinsurers is an option, period, and the success of the dual banking charter system is a simple testament to how and why it will work.

The primary objective of insurance regulation is to monitor and regulate insurer solvency, the most essential consumer protection, as it will remain so. While some risks and insurance markets remain local or State-based, in general, insurance has become an international marketplace in which risks are widely spread and losses are widely felt. Rather than encouraging increased availability and improving affordability of insurance to cover such risks, the State regulatory system does just the opposite. By artificially making each State an individual marketplace, it constrains the ability of carriers to compete and, thereby, reduces availability and affordability.

Let me give you a couple of examples.

Transparency with respect to compensation is a hot issue, and we support uniform disclosure rules. While the States impose explicit requirements, it is impossible to satisfy the differing requirements of the States with a uniform compliance approach. For clients with exposures across the Nation and their brokers who are trying to serve them efficiently and economically, the differing requirements serve no apparent consumer-protection purpose.

The second example is licensure. After the enactment of Gramm-Leach-Bliley and its NARAB provisions, the NAIC pledged not only to reach reciprocity but, ultimately, to establish uniformity in producer licensing. Most States retain a variety of individual requirements for licensing, and they all differ with respect to fees, fingerprinting, certifications, among other requirements.

The 183 producers in my firm, for example, hold 183 resident licenses in four States and 512 nonresident resident licenses. As you can imagine, this requires significant monetary and human resources.

Seven years after NAIC's adoption of a Producer License Model Act, the regulators still cannot agree on the meaning of basic yet critical terms that are contained in every State law, such as what it means to sell, solicit, and negotiate insurance. Nor can they agree on the meaning of other critical provisions of the law, even when the language in their individual State provisions are identical word-for-word. While these may seem like small issues, and individually they may, taken as a whole they are significant. Commissioner Bell accurately recounts the efforts that regulators are making to achieve results at the State level, but that is no substitute for Federal action on the matter.

My third example is speed to market. Let me give you a personal story. A few years ago, PAR, an errors and omissions insurer for whom I am a director, needed to revise its coverage form. PAR had to refile the coverage form in 35 States where PAR writes coverage for 65 insureds. After 2 years and huge cost, all 35 States approved the filing. Every policyholder in this insurance company is a sophisticated insurance executive. Two years and massive cost is absurd. We advocate for complete deregulation of rates and forms for commercial lines of insurance.

Finally, although the NAIC has attempted to institute regulatory reforms without Federal involvement, the reality is that today's marketplace demands far more dramatic action than the States alone are able to provide. Competition and efficiency in the insurance industry lag behind other financial service sectors largely due to the regulatory inefficiencies and the inconsistencies in the State regulatory system.

I am grateful for this committee's interest and work, but the root of the complaints that I see against the OFC proposal are inherently protectionist. The business of insurance and the consumers that business needs to serve have moved beyond artificial State boundaries, and it is long past time that the regulation of that business move beyond those artificial boundaries as well. Companies and producers should have a choice between State and Federal oversight, and consumers should be able to choose between companies and producers who can provide the best service and the best performance.

Again, thank you, Mr. Chairman.

[The prepared statement of Mr. Counselman can be found on page 101 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Counselman.

And now, Mr. William McCartney, the senior vice president for insurance regulatory policy, USAA.

Mr. McCartney?

STATEMENT OF WILLIAM H. McCARTNEY, SENIOR VICE PRESIDENT, INSURANCE REGULATORY POLICY, UNITED SERVICES AUTOMOBILE ASSOCIATION, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Mr. MCCARTNEY. Chairman Kanjorski, Ranking Member Pryce, and members of the subcommittee, good afternoon. My name is William McCartney, and I am senior vice president, insurance regulatory policy, United Services Automobile Association in San Antonio.

USAA was founded in 1922 by a group of 25 Army officers who found that they couldn't get automobile insurance because typical insurers equated their frequent moves with being bad risks, so they started their own insurance company. Today, USAA is a fully integrated financial services company, providing insurance, banking, and investment products to six million current and former members of the U.S. military and their families. Our mission is to be the provider of choice to the military community.

I am testifying today on behalf of USAA and our property casualty insurance trade association, the American Insurance Association, and the American Insurance Association's more than 350 members.

Today, I will talk about an insurance regulatory framework that hasn't been updated since 1945, when FDR was President and this Nation was at war with Germany and Japan. No other segment of our economy has gone that long without being modernized. We strongly support H.R. 3200 as a vital means of rationalizing this industry for consumers today.

By way of background, earlier in my career I served for 7 years as Nebraska's Director of Insurance. During that time, I was active in national insurance issues and served as an officer of the National Association of Insurance Commissioners for 3 of those years, including as NAIC president in 1992.

I have always believed that the primary and overarching focus of insurance regulation must be on the financial condition of insurers, and I used to believe that the States could achieve uniformity and consistency of regulation without Federal intervention. In fact, in the early 1990's, in a hearing before a House Energy and Commerce Subcommittee, I asked the members to give the States time to plug the holes in State regulation; and I told the subcommittee that if the States failed to do so, I would be among the first to come back and tell that to Congress. Well, 15 years later, here I am.

The fact is, today's State-based regulatory approach is misguided. The system of price and product controls empowers regulators, not consumers. It creates instability and disorder, not uniformity and consistency. And, finally, continuing in the current system will put consumers at greater risk by driving insurers out of markets, rather than promoting solvency.

Today, let me mention just one example of how the current system does not empower consumers. As Mr. Royce said, each year a third of USAA's members move at the direction of the Federal Government. I would like to tell you about one, but because he is on active duty right now, I have to protect his name.

He is a sergeant who serves in the United States Army. Pursuant to Federal order, he has moved nearly every year since he enlisted. He recently purchased a vehicle in Georgia, his home of record, but shortly thereafter was moved to Texas. All it took was a change of address form to update his checking and savings accounts, credit cards, mutual funds, and retirement accounts. But unfortunately for this sergeant and every member of the Armed Forces, his automobile, renters, and umbrella insurance products are not portable. So, for these, the change of address form was just the beginning.

Even though he had the same risk profile in Texas as he had in Georgia, USAA had to reunderwrite, reprice, and reissue each of those products on a Texas policy form, and some of the coverages changed because of State requirements. We also had to send him new proof-of-insurance cards in a Texas-specific format. Next year, when he moves to some other State, we will get to do it all over again.

Instability and disorder, not uniformity and consistency, characterize the current system. Imagine if cell phones were regulated the way we regulate the insurance industry. What if your cell phone coverage ended when you crossed a State line or that the provider required a different model phone for each State? Would consumers pay for a service that required them to have three, four, or five plans, or carry three, four, or five different telephones every time they crossed a State line when on vacation or, in the case of our military men and women, change duty stations? Imagine the effect that that would have on communication. Consumers wouldn't stand for it, and neither would Congress.

And the current system puts consumers at greater risk by driving companies out of markets, rather than focusing on promoting solvency. In spite of the States' continued assertions that improvements have been made and are under way, the fundamental problems have not been significantly addressed, and they cannot be.

We are dealing with a system that has 51 regulators and 100 separate legislative bodies. Most insurance regulators want to do a good job and have the best of intentions, but they are limited in what they can do under a regulatory design that is over 60 years old.

So what should Congress do? We urge you to enact H.R. 3200, the National Insurance Act of 2007, sponsored by Representatives Bean and Royce. This bill would create a national insurance framework, but it would allow insurers that want to remain State regulated to do so. Similarly, consumers who want to deal only with insurers subject to the oversight of their State regulator could choose to do business only with those companies. However, consumers who value consistency of products and service, regardless of where they reside, like our men and women in uniform, could choose to do business with nationally regulated insurers.

Thank you for allowing me to appear here today and for holding this hearing on this important issue. I look forward to responding to your questions.

Chairman KANJORSKI. Thank you, Mr. McCartney.

[The prepared statement of Mr. McCartney can be found on page 122 of the appendix.]

Chairman KANJORSKI. And finally, Mr. Alex Soto, president, InSource, Incorporated, testifying on behalf of the Independent Insurance Agents and Brokers of America.

Mr. Soto.

STATEMENT OF ALEX SOTO, CPCU, ARM, PRESIDENT, INSOURCE, INC., ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA, INC.

Mr. SOTO. Good afternoon, Chairman Kanjorski, Ranking Member Pryce, and members of the committee. I am the immediate past president of the Independent Insurance Agents of America, and immediate past chairman of the same organization. You know it as the "Big I."

We are 300,000 men and women across the country. We are the intermediaries between the insurance companies and the consumers. Because we are independent agents, we represent multiple insurance companies, and we thank you for holding this hearing on an area that is of critical importance to all consumers and our clients.

The current system of State regulation does indeed work, and in particular State regulation does work effectively to protect consumers. State officials are positioned to respond to the needs of the local markets and the local consumers. Also, protecting consumers against insurance company insolvency, which is the primary goal of the regulator, is done effectively at the State level, I think most people would agree.

However, the State system also has been rightly characterized as slow and inefficient, with different laws and regulations that add unnecessary expense; and we believe that congressional legislative action is necessary to help reform the State regulatory system. The IIABA believes that the best method of addressing the deficiencies is a pragmatic, middle-ground approach that utilizes Federal legislative tools to establish the greater interstate consistency in key areas, and so we navigate the middle ground in the various positions.

Evidence of the viability of this approach is the Nonadmitted and Reinsurance Reform Act, which passed the House overwhelmingly by voice vote this year and unanimously last year. Unlike other reform proposals, this legislation has near unanimous support.

An additional area where targeted reform could be achieved is in the area of agent licensing. We already talked about it.

The more serious challenges facing the people that I represent, my constituents, is a redundancy in the cost requirements arising when seeking nonresident residence licenses, and Mr. Counselman already alluded to that.

In most States, a person such as myself who wants to transact business in a neighboring State has to get three separate licenses, one for myself, one for my agency, and on top of that we have to register the corporation in each jurisdiction just to simply serve our clients. We believe that targeted Federal legislation preserves the right to States to supervise and discipline individual producers but would not impact the day-to-day regulation of insurance.

I would be remiss in not discussing briefly our strong opposition to another suggested method to achieve reform, which is the creation of an optional Federal charter. If insurance regulation is shifted to the Federal Government, our agents would not be as effective in protecting consumers. Let me take the time, because time is brief, to give you just one simple anecdote.

When Hurricane Andrew hit my area—and I live in Miami, Florida, and unfortunately we have lived through a number of hurricanes—we had started the year before in an orderly moving of a book of business from one major national insurance company to various companies. We had agreed not to do business together anymore, and we agreed to do it on a month-by-month basis as policies expired and not to disturb mortgagees, additional insureds, and the insureds themselves. Unfortunately, toward the end of the process, in August of 1992, Hurricane Andrew struck, and we found ourselves at InSource with 17 insureds who were about to be nonrenewed but had substantial damage to their properties. Roofs were blown off. Walls had been torn down.

I made an appeal to this national insurance company for help. Please maintain the insurance for these people until they can repair the property sufficiently to get another company attracted to write their insurance. I made a home office appeal. I went through their government affairs officer and was turned down every single time.

I then made an appeal to the insurance commissioner of the State of Florida, and the next day we got an emergency order requiring that insurance company, for a limited period of time, to renew the policies for these people.

I am going to tell you that I cannot imagine a Federal regulator or series of regulators or series of ombudsmen being able to protect the consumers at that level, and that is why we believe in not dismantling the existing process but rather improving it. Even though—even though optional Federal charter is mentioned to be optional, it is not optional for our members and it is not optional for the clients that we represent, because invariably we are going to have to place some of them with companies that are State regulated and others that are going to be regulated by the Federal Government. We would be forced to deal with a Federal regulator and a State regulator.

Proponents of OFC also assert Federal regulation is important if the United States is to remain a global financial services leader. IIABA believes that purported decline in U.S. capital markets' competitiveness for insurance companies does not stem from State regulation but rather other U.S. competitive concerns, such as disparate tax treatment, diverse financial reporting standards, and excessive costs of litigation.

So, in conclusion, we believe that targeted Federal legislation to improve State-based systems presents the Members of Congress with a compromise that is achievable and something that we can all work on together.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Soto can be found on page 136 of the appendix.]

Chairman KANJORSKI. Thank you, Mr. Soto.

In listening to it, it seems we have rather diverse testimony. Some people think we have a problem, and others do not see it that way. And sometimes, I wonder whether we are providing a solution in search of a problem. And of course, what I mean by that is obvious, that there is no reason for us to move ahead. But I seem to hear a recognition from all of the witnesses that things could certainly function a lot better than they do.

Starting with that proposition, what I would like to know is what would be the number one, two, and three issues that should be addressed if you had the choice of telling us what to address? Anybody on the panel who wants to take that.

Mr. CONDRON. I would say time to market is very critical, because we are disadvantaging consumers in terms of how long it takes us to put a new product on the market. I will give you just a quick example. Our Accumulator 07 product after 7 months still isn't approved in five States, and one of those States will never approve the product.

Secondly, I would say consistency in reserve requirements. The way the system works now, individual States can require different reserves, which is basically your cost of capital, your one asset, can require different costs of reserves by State. So New York can require different reserves than Arizona; and, as a result, companies end up being inconsistently regulated across the system.

And I would say, finally, that the inability of our current system to allow our agents to freely work across State lines—you know, a simple example would be if a client moves from Pennsylvania to Arizona and they want to talk about their insurance policy and their Pennsylvania agent isn't licensed in Arizona, they can't talk to him, and he is probably not going to want to get licensed in Arizona.

So the example that was given about moving, the USAA problems of people moving around, the State licensing system is arcane. No other part of financial services requires State licensing State by State. They have blue sky laws in the securities industry, where you take one exam, you are automatically licensed in every State. That doesn't exist in the insurance industry. So I would say those would be my three.

Chairman KANJORSKI. I think that is very good. That is a good start, as far as I am concerned.

We have three elements here, none of which really requires a Federal charter. Time to market, we could easily do that. It is something we do in Pennsylvania in agriculture. If you meet the Pennsylvania Department of Agriculture requirements, you are capable of doing business in all 50 States in the country. That is by Federal act.

We could easily say if you qualify under New York State insurance regulation or California State insurance, or whatever State we pick as an idealized standard, that would qualify that product that you are interested in getting to market immediately, so you would have only one market to put it through.

The reserve requirements would be pretty much the same thing, that uniformizing a reserve requirement. Whatever is determined to be the reserve requirement in the select State or States, it would be uniform throughout the country. As for agents working across State lines, that would be in conjunction with licensing, which would be easy to uniformize, it would seem to me.

Mr. CONDRON. Well, the States have been at it for a long time. Today, 30 States are in a compact. They have been at it forever. The big States aren't there. New York is not there, California is not there, Florida is not there, and they are likely never to be there.

Chairman KANJORSKI. Why is that, sir?

Mr. CONDRON. Because each State has different rules and regulations. Some are required by the State legislature; some changes are required by the State senate. So the insurance commissioners themselves as a group, a very able and hardworking and diligent group of people, they have their hands tied. And you have different goals in different States. And you know, we have been at it for a long, long time now trying to get uniformity, and it hasn't happened, and, frankly, it never will.

Chairman KANJORSKI. Mr. Counselman?

Mr. COUNSELMAN. Mr. Chairman, thank you.

I come at it from a different direction, I think. I think there is a fundamental change in how business is done in the United States today versus how it was done when I came into the business, which was 35 years ago, when my association, the Council of Insurance

Agents & Brokers, was started, which was 94 years ago; and I think that the fundamental change is that our clients are doing business nationwide and internationally. So, therefore, that is how we are doing business. Even if I were just one office in one city, I would be doing business throughout the country all the time for my clients and also out of the country all of the time for my clients, and that was the exception in the past.

So I think that what we have now is something that was designed to fit what was appropriate when it was designed, but we need a fundamental change in how regulation is done today to reflect how business is done today, which is all the time, even from small offices of our member firms as well as from larger offices of member firms, business is done nationally and internationally on a daily basis. And so we are trying to make something fit, and it takes us a long time to make change through 50 legislatures, and we just can't move fast enough that way anymore.

It just doesn't fit. The model doesn't fit anymore, and that is why I think we have to take this opportunity to look at this and say, what is the right way to build it? How can we really protect the consumer? And then also at the same time allow the insurance companies and the agents and brokers to flourish in serving the consumer.

So I think the fundamental change that we have to look at is completely change the structure, and that is why I think OFC is so important, because that will cause it to happen.

Chairman KANJORSKI. Mr. McCartney?

Mr. MCCARTNEY. Very briefly, Mr. Chairman. Thank you.

And with all due respect, I think I need to disagree with the fundamental premise of your question that there are two or three or four issues that we can tackle and then the problem will go away. I just don't believe that we can do this piecemeal. We have to have an approach that deals with the entire problem.

And, you know, from my perspective, representing a company that represents men and women in uniform, anything that doesn't cover the whole range of products probably is not going to be a satisfactory solution.

Chairman KANJORSKI. So your theory is we need to go from this point to a Federal system overnight?

Mr. MCCARTNEY. I think your analogy of how the Pennsylvania Department of Agriculture standard then becomes accepted in every other State is one that might have some merit to talk about.

At the same time, though, it really has to have some teeth, because in the States where the Federal Government has come on with directions and mandates to the States in the area of insurance, by and large the States haven't been able to get there.

Chairman KANJORSKI. It is an interesting discussion. I do not mean to eat up all the time, but the discussion had a lot of the fear of fairness and who would have priority if we have a dual system. In a dual system, I see a need for insurance companies to have a right to do business in one single State or one or two States for those that do not wish to go national. But you could construct a system that way, and then you end up with forum shopping and you end up with some States setting up regimentations that are advantageous to attract business as opposed to accomplishing business. And you get that—we have it in some of the areas—shopping around, if you will, for forum or license. And rather than see that, we could go to a Federal system that maintains a State system within categories of control so that if a State system gets out of control, the Federal regulator would have authority to come into place.

Mr. Soto?

Mr. SOTO. Mr. Chairman, I agree with the way you started your statement and your question, which is if you create a laundry list of problem areas—and, obviously, for selfish reasons, agency reform and licensing reform would be about at the very top of my list, but also speed-to-market issues and forum regulations issues. And you target them and you go at them and therefore preserve those qualities that are still good in the State system.

I mean, the fact is the State system has a lot of problems, but we don't need to demonize them. So there is a lot of good experience there, wealth of background and information, and let us preserve it, but let us target the areas where we need change.

Chairman KANJORSKI. I have to state my preference. I have great fear in creating another Homeland—what is the name of that agency?

Ms. PRYCE. Homeland Security.

Chairman KANJORSKI. The Department of Homeland Security. I cannot even remember the name of the agency, but it is a disaster. And, you know, it has been in effect for 5 years and probably will not get straightened out for another 5 years, because that is the way the Federal Government functions.

I can't imagine what we are going to do if we take a huge industry like the insurance industry and screw it up for 5 or 10 years before it gets its feet in place. It could be a disaster. You know, I don't want to be a solution in search of a problem. I think that is what we could do if we want to do the magnificent total picture of reinvention.

Anyway, I have spoken enough. Ms. Pryce?

Ms. PRYCE. Thank you, Mr. Chairman.

Following up on some of the issues you touched on, two things concern me the most about this issue. And let me just tell you what they are, and then you can all jump on them if you care to.

One is the global economy and how insurance is affecting that, how we are working through those issues on a State-by-State basis. You know, we talk in this committee a lot about trade in services. Right now, who does represent your industry when it comes to negotiating trade deals? We have heard from Schumer and Bloomberg and the U.S. Chamber that we are suffering a competitive disadvantage because of State-by-State regulation. Mr. Soto disagrees with that. He thinks it is because of taxes and litigation, other things. So that is my first one.

The other is, you know, the retirement security crisis and how these new products, especially on the life side of the industry, can contribute to helping us solve this big problem that our country faces, and are we as a government standing in the way of the assistance that this country really needs because we are allowing each State to independently and specifically regulate—perhaps regulate these solutions out of being?

And so that is two big questions, and who wants to go first? All right. Let us hear from Mr. Bykowski.

Mr. BYKOWSKI. Thank you.

First of all, I would like to thank the chairman for his comments about concerns of creating this huge Federal bureaucracy, because certainly NAMIC would share those concerns. And we would like to talk about one of the key issues facing the regulatory reform we believe is the issue of rate regulation, heavy rate regulation in some States. In those States that have a reasonable regulatory system for handling rates you will find the most competition.

In my home State of Wisconsin—

Ms. PRYCE. Are you addressing either one of my problems here?

Mr. BYKOWSKI. I can't speak to the life insurance questions.

Ms. PRYCE. Then how about the global economy question?

Mr. BYKOWSKI. Well, there is no doubt that we live in a global economy. But the insurance world, particularly the property casualty insurance world, has to deal with the local issues that affect it. The problems that we have in Florida are not the same as we have in Wisconsin or in California.

Ms. PRYCE. So Mr. Condron?

Mr. CONDRON. Yes, first of all, Congresswoman, I would say AXA is an interesting example, because we are in 50 countries. And when you come outside of the United States of America and you say who represents the insurance industry in the United States, the NAIC tries to be a body that speaks for the insurance industry, but they can't commit the industry. They don't have any power to commit the industry. They don't have the—they are not vested with the power from all the States. Each State views each issue differently.

So, from a trade standpoint, we are at a competitive disadvantage globally, and I think that is something that really needs to be considered. Because the securities industry, the banking industry, and all of the other financial services industries are well represented by a Federal regulator who can represent them globally in the global marketplace.

Turning to your retirement security question, let me give you an example. In 1975, the average price of a home in this country was $47,000; today, it is $181,000. In 1975, the average price of a gallon of gasoline was $0.57; today, it is over $3. Think about if you retired in 1975 and think about how you would be able to pay those incremental costs if you hadn't invested whatever nest egg you had accumulated in some kind of investment that would have grown over time.

And the beauty of what our industry does is we allow people to make investments in the securities industry, in the capital markets, and we put downside protection in place for them. So today someone age 60 puts $100,000 into a variable annuity contract, they pick whatever investment they want, and we guarantee them that after age 70 they can trade that investment account, regardless of how little it might be worth, for guaranteed income for life. So beginning at age 70 that 60-year-old could get $11,000 a year for life or all of the upside from their investment portfolio. Those are the kinds of products our industry is providing.

Ms. PRYCE. And the current system is in the way of those products coming to market quickly?

Mr. CONDRON. Sure. We can't get those products out there. We can't get them approved. And when we get them approved, there are different variations in different States, different minimum guarantees they will allow us to offer, different reserving requirements, which means different costs to the consumer. So there is an inconsistency.

I will give you another example. In Chicago, in Illinois a year ago, there was only one person who approved any insurance products for the whole State. So everything just sat there in line waiting to be approved, and we waited a year for one of our products to be approved in the State.

Ms. PRYCE. In fairness, Mr. Bell, do you want to have the few seconds I may get left from the chairman?

Mr. BELL. Thank you, Congresswoman Pryce.

You mentioned the global economy. In some of the ACLI's representative, in terms of their talking of the global economy from 1977 and 1987, well, if you look back 10 years ago, the global market was very different than what it is today. China had not entered the global market at that time. India had not entered the global market at that time. So two-thirds of the world population have come on line basically in the global economy within the past 10 to 15 years, and so that is making a very different kind of situation in terms of what is going on from the Schumer report out of New York talking about where it is.

Shanghai was not a marketplace. Hong Kong was a very small marketplace in terms of the global market. Taking the capital from New York, London was not even doing nearly what it is doing today.

Mr. SHERMAN. [presiding] Thank you, Mr. Bell.

The time of the gentlelady from Ohio has expired.

We are not going to recess. I will be in this chair until Mr. Kanjorski can come back. We have one vote.

Mr. Condron, you suggested that this Federal charter is a good way to be able to protect people from outliving their savings. My concern is that no one in the insurance industry is willing to market—it is not the regulators' fault—an inflation-adjusted—a genuinely inflation-adjusted longevity policy. Are you aware of any insurance company that is trying to—and I don't mean something tied to the stock market, I mean something tied to the Consumer Price Index—that is trying to market a policy that will assure somebody that if they outlive their savings and they live to be 100 years old—and we all aspire to that—that they will be able to afford the then existing prices?

Mr. CONDRON. Yes, I am not aware of any specific product on point, but I would make the point that it is a very doable product to design.

Mr. SHERMAN. It is a doable product to design. The problem is not these regulators.

Mr. CONDRON. Yes, it is.

Mr. SHERMAN. The problem is that it is a lot easier to sell a non-inflation-adjusted product, which sounds great to the 50- and 40- and 30-year-olds in my district, but it isn't going to buy them a hamburger in the year 2060 or 2050 or whatever year they—in any case, voting for this Federal charter isn't going to get me the kind of longevity protection that I would like to see from my constituents, because, as far as you know, nobody wants to sell it.

Mr. CONDRON. We are already providing longevity protections.

Mr. SHERMAN. But not inflation-adjusted.

Mr. CONDRON. Not directly. But if you look at the historical performance of the stock market, it is triple the rate of inflation.

Mr. SHERMAN. Given the phenomenally bad economic policies and trade policies we are following, I wouldn't tell any of my constituents that they were safe unless they had inflation adjustment. And nobody wants to sell it. And it is not the regulators' fault. You know your industry pretty well, and there is not anybody who is trying to register such a policy.

Mr. McCartney, you put forward all the problems of somebody moving from Georgia to Texas. They had to be rerated. They had to get a new card of proof of insurance. But if we are going to solve those problems don't we need to federalize the tort system and federalize the vehicle code? It occurred to me I moved from one part of Los Angeles to another, I had to be rerated. So, you know, the guy moves from Georgia to Texas, he has to be rerated. Are we going to have that seamless moving from Georgia to Texas if we just have an optional Federal charter?

Mr. MCCARTNEY. First of all, the optional Federal charter bill, H.R. 3200, does not replace State tort laws or premium taxes or anything.

Mr. SHERMAN. So if I move from one State to another I expose my insurance company to additional courtroom risks. If I move from one neighborhood to another, which obviously occurs in a State move, I expose you to higher risks or lower risks that I will be in an automobile accident. So if I move from one place to another, you and I are going to have a lot of paper and a lot of telephone conversations before we are done updating my policy even if you don't get an optional Federal charter or you do. We still have all these other problems.

Mr. MCCARTNEY. Mr. Chairman, there is absolutely no reason why USAA could not provide a USAA member with a 3-year policy. There is no reason for it to be reissued. If somebody moved from Nebraska to Michigan, Michigan has a no-fault law. The policy would provide that we will provide whatever benefits at whatever limits you have suggested are required by the State. There is no reason—it may need—

Mr. SHERMAN. So my insurance company, though—I mean, we at least have one regulator for the whole State of California, and the insurance companies could give you a different rating when you go to renew your policy if you just move from one neighborhood in LA to another. So there are different risks, apparently—at least my insurance company thought so—if I just moved within a jurisdiction.

But I want to move on to Mr. Bell. My concern is that at least one State could have a major depression in its own State, be desperate for the kinds of jobs that they could get if they could just get some insurance companies to move in. If let us say the State of Desperation were to establish really low capital requirements and some insurance companies moved into that State and had very low capital, could they still sell insurance in my home State of California?

Mr. BELL. That is a very good question, Congressman. What would happen is that your insurance commissioner would then look at the application once that State came across. And if in fact if it was national, then they would be able to. If it was a Federal charter, they would be able to. But if on a State-by-State system—

Mr. SHERMAN. I mean under the present system.

Mr. BELL. Under the present system today, that particular insurance commissioner could require additional deposits.

Mr. SHERMAN. So if I am an insurance company in Nebraska, I don't have to just convince Nebraska officials that I am safe and sound, I have to convince each and every State that I have adequate capital.

Mr. BELL. They may have registered and became licensed in Nebraska 10 years ago and they are just moving into your State. So their financials could very easily change over that time. As you know, the financial statements can change on a day-by-day basis, let alone over time.

Mr. SHERMAN. So I have 50 different regulators all deciding whether on a particular day I have sufficient capital to be able to pay off if I have a disaster or whatever else would cause me to have to write a lot of checks to a lot of consumers.

Mr. BELL. As we look at a lot of financial statements on insurance companies, we see that from quarter to quarter there are drastic changes in their financial situations, and that would say what the commissioner is looking at at that particular time, yes, sir.

Mr. SHERMAN. I would point out that my time has expired, and yet there is no one else here to yield to. I will stay here for about 2 more minutes, and then I will rush on over and vote. Hopefully, by then another member will be here asking questions. We have 4 minutes to vote, so really just a minute-and-a-half to ask questions.

I will ask—let me see, part of your name is hidden, sir, so I will just say Mr. B. We have 14,000 regulatory employees in the various States. Now if half of the companies get Federal charters, do 7,000 of those folks have to move here to Washington, or do we fire those 7,000 and hire a different 7,000? We lose their institutional memory, or is that institutional memory useless because it is about how to do State-by-State regulation? And if we are not going to fire half of those 14,000, but we are going to have to hire another 7,000 here in Washington, what is good about moving from 14,000 to 21,000 regulators?

Mr. BYKOWSKI. I don't believe that there is anything good about moving the regulatory environment from the States to Washington. We are certainly not in favor of that.

I can point to the regulatory environment in the State of Wisconsin, where we have 900 companies licensed to do business and over 100 domiciled companies in the State, and we have a tremendous competitive marketplace. And the regulatory—

Mr. SHERMAN. Let me redirect that question also to Mr. Counselman, whom I know does favor a national charter.

Mr. COUNSELMAN. Mr. Chairman, I think that we would see different—there would be a movement, yes. But it would be gradual, and it would only require those to move who are actually having to approve the licensing approvals.

Mr. SHERMAN. So how many Federal employees would we have to hire here in Washington?

Mr. COUNSELMAN. I certainly don't think I could even guess at that number, but it would be certainly displacing some of those that are—

Mr. SHERMAN. That is the 2-minute warning. We stand in recess.

[Recess]

Mr. MOORE OF KANSAS. [presiding] If we could resume, please, and we will get this hearing going and finished. And Mr. Baker, you are next, sir, if you would.

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

Commissioner Bell, there is an old country and western song that starts out, "You had me at hello." You created a slightly different version for me today. It is called, "You lost me at hello." I have to revisit a little history with you on where my personal frustrations lie in all of this.

Mr. BELL. Yes, sir.

Mr. BAKER. As chairman of the Capital Markets Subcommittee 7 years ago, a witness appeared that in the statement said, with regard to modernization, we are just around the corner from it.

Six years ago, I had a hearing, and they promised me uniformity for product review in a program called CARFRA.

Five years ago, President Vaughn testified the interstate compact was the solution, and she expected very quickly to get a significant group of States in place to make the interstate compact operational.

However, 4 years ago when Chairman Vaughn reappeared, at that time before Congresswoman Biggert, asking the question about the failure of CARFRA, Chairman Vaughn replied that the main thing came down to the deviations that were in place. No kidding. I bet it took a lot of study.

In looking at a hearing that Chairman Oxley was involved with 7 years ago, Chairman Oxley asked both the commissioner of Michigan, Commissioner Fitzgerald, and Ohio Commissioner Covington this question: "If Congress sets a goal of 3 to 4 years for achieving comprehensive uniformity by NAIC for product approval, do you, Mr. Fitzgerald, feel confident that you can meet that goal? And you, Mr. Covington?"

Mr. Covington responded first: "Chairman Oxley, I think we have to meet that goal. As said before, the current system is not good for consumers. It is not good for insurance companies. We must meet that goal."

Mr. Fitzgerald responded, "I agree with that. If over the next 2 to 3 years you have not seen significant progress, I think there needs to be questions raised about whether we can effectively at the State level solve the problems you have identified."

That was 7 years ago.

Now, I have a piece of correspondence from the NAIC in reference to what was then known as the SMART Act, which turned out to be not so smart, asking for a comment on that legislation.

It was 47 pages. The "Dear" and the "Sincerely" were the only two friendly words in that 47 pages.

I have to say, as an organization, the one most likely to drag the effort to reform down will be NAIC. There is an inability to reach a political willingness to understand that the organization's reluctance is not just about whether somebody puts their stamp on a piece of paper, it is about whether the people who work and pay taxes and who have to have insurance as a matter of economic necessity, not because they choose to buy it, can get access to a product that meets their needs at a decent price.

Now as to the compact that you just mentioned that was adopted, 30 States, I believe you said, were engaged in that process. The scope of that compact, is that life only or is that everything?

Mr. BELL. Congressman, that is life, annuities, disability, and long-term care. It is a product that we are working that we think has some basis that we can do that on. We have 36 national standards in that compact now.

Mr. BAKER. Let me ask this question. My staff told me—and I have no way to know this. My staff told me there have been perhaps over 300 product approvals since that compact has gone into place. Is that the correct number?

Mr. BELL. Three hundred?

Mr. BAKER. Yes, sir.

Mr. BELL. The compact was started, took its first filing in June of this year. I don't know the number, but I don't think it is as high as 300 yet.

Mr. BAKER. Is it over 100?

Mr. BELL. You know, we have the director of that compact here with us today.

Mr. BAKER. Would they be available to kind of shout out a number?

Mr. BELL. We received six filings today, and there are many others in the queue.

Mr. BAKER. Out of those six, how many of those—or are they just all in the queue?

Mr. BELL. That was received today.

Mr. BAKER. Oh, today. Okay. You are not saying that is the total number of receipts; you are just saying that is what is in today's mail.

Mr. BELL. That was what was received today.

Mr. BAKER. I understand. Could you at some time tell the committee in the form of correspondence what the status of the compact result has been, maybe with some sort of monthly progress report? We would just like to see what is really going on there. Because it appears—

Mr. BELL. We would be happy to provide that.

Mr. BAKER. I appreciate that. Because there seems to be great reliance on that in your testimony that that is a notable achievement, and I have my doubts.

With regard to the paper clip and colored paper requirements, I looked quickly—I didn't have time, because I wasn't expecting that—at the e-file SERFF system. I believe that is the system to which you make reference that gets people into the technological—

Mr. BELL. That is correct.

Mr. BAKER. Now, if I were a company and I had a product that was going to be sold in all States, how many times would I have to enter that data? Could I sit down once and fill out a form and be done?

Mr. BELL. Yes, sir.

Mr. BAKER. That is not what I have been told. I have been told that if you are going to file and sell in the various States, you have to file a different form for each State. You have to hit that computer 50 or 51 times. Now, is that wrong?

Mr. BELL. I am not sure how many times you have to hit your computer enter button, but we know that 50 States are using SERFF and that 46 States accept all major lines and 50 accept all PC lines.

Mr. BAKER. Well, I am told that each State still maintains its own approval variances, that the form is not a single form which someone can fill out one time and thereby be filed in all appropriate States to market that product.

I would like to have a follow-up, if I may, on what the approval process looks like and whether in fact when the recipient entity gets the document do they in fact copy that filing and put it by paper copy into a file and then reenter the data into their own electronic storage system? And do some States actually require a written correspondence from the applicant that shows an original handwriting on a paper document which is generated at the State end and mailed back to the applicant? Yes, that is correct.

Mr. BELL. You answered the question for me, Congressman.

Mr. BAKER. Thank you. Let me point out that if there is an ability to get this done, your organization has to take on the substantive policy reality of this problem. You are costing this country and the consumers of insurance products millions of dollars in wasted time and premium.

Now, I know the view is that you stand between those in the market who would dupe and take advantage of the innocent consumer of insurance product. This is a competitive world, and Eliot Spitzer is still alive and well, and there are a whole lot of them all across this country willing to take on anybody who violates their fiduciary duty. But there is no public service served by a recalcitrant approach to say no to reform at any level, at any level. And laying claim each time you appear before this committee, as you have in my entirety of hearings on the matter of insurance reform, we are 2 to 3 years away. We are 2 to 3 years away. You ought to put it to music. It is a great song.

Thank you.

Chairman KANJORSKI. The gentleman from Kansas, Mr. Moore.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

To the members of our panel, in the 109th Congress the surplus lines industry presented a compelling case that there existed serious regulatory problems with their market that needed reform. I worked on a bipartisan basis with Ginny Brown-Waite of this committee and in the House to pass legislation that would ease some of these burdens and create a more uniform regulatory system. Can any of you, if any of you care to, please tell me specific examples of problems that you, your company, or trade association have with the current insurance regulatory system?

Yes, sir, Mr. Counselman?

Mr. COUNSELMAN. Congressman Moore, I would like to thank you for your leadership in that area, because it has been significant.

We have—we do filings whenever we make an excess of surplus lines placement, and we have to do it in each State in which there is a risk on the policy. And the filings themselves are different, the requirements are different in each State, and you have to file different directions and compute the tax separately. We go through that process—I would say in my office we go through it on a weekly basis, not a daily basis, with different risks that we insure. And it is usually part of a program, it is not the entire program, but parts of the policies. And because of that legislation, we feel that we are going to have a uniform way of providing that filing in the future. So we are going to have real savings to the customer in the future.

Of course, it has just happened, but under the current system we pretty much have to guess where the proper premium allocations go to which State, and we have to follow—I don't know if it is colored paper. I don't know about yellows and pinks and greens. I don't think it is colored paper, but it is different types of paper, and it has to be different types of filings. So it is very complex, and it is about to become very simplified, and think I think that is going to result in more coverage being available to more insureds, because of the simplification.

Mr. MOORE OF KANSAS. Thank you, Mr. Counselman.

Anybody else care to comment?

Mr. CONDRON. I think what you have done is terrific, but it is tackling a piece of a bigger problem and no different than Congressman Kanjorski's question about what are the three big issues. Well, they are the three big issues, but, as Mr. McCartney said, you know, it is much more complex than that.

Mr. MOORE OF KANSAS. Sure.

Mr. CONDRON. So a holistic approach to solving this problem on behalf of the consumers in this country, I think, is what we would ask you to be serious about considering.

Mr. MOORE OF KANSAS. Thank you.

Anybody else?

Mr. BELL. Congressman, I think that when we start looking at how the filings are being done, 60 percent of the filings are being done electronically these days and there is no paper involved. In the State of Alabama, we have even gone as far as to say that you have to use the SERFF system, and other States have done the same thing. So we can get away from this anecdotal stuff of paper filings, what kind of papers you use, what kind of paper clips you use and whether you put them in the left-hand corner or the right-hand corner.

Mr. MOORE OF KANSAS. Thank you, sir.

Mr. SOTO. Congressman, if you notice that even though we differ at this table as to the methodology, we all happen to agree with you that that is a great step forward, and that is why we believe that pragmatic, middle ground to attack these problems and get them solved takes us away from arguing whether aspects of a massive plan are going to be detrimental, we are going to have a tremendous increase in the Federal bureaucratic process or not, whether you believe in it or not. But this is a pragmatic approach which is working. We salute you for it.

Mr. MOORE OF KANSAS. Thank you.

Yes, sir, Mr. Bell again.

Mr. BELL. We hear a lot about the regulatory systems. Well, all of the companies do not do the same kind of things. Some companies use credit scoring when it comes to a filing. Some companies do not. So the regulatory scheme will have to take into consideration the variance from over 7,000 insurance companies in this country. If we could get all insurance companies to have one application, then we would solve a lot of problems. But I don't think that is going to happen, and we are not looking for that to happen.

But I do not think that is going to happen, and we are not looking for that to happen.

Mr. MOORE OF KANSAS. Thank you.

Thank you, Mr. Chairman.

Chairman KANJORSKI. The gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you.

I was going to ask a question of Mr. McCartney.

Given your previous position as a former president of the NAIC—I think you said it was in 1992—I thought I would go back to this quote that Congresswoman Pryce had collected, that she started with, and the quote comes from George Miller, the founder of the NAIC in 1871.

Again, what he said was, "Insurance law shall be the same in all States, not reciprocal but identical in all States, not retaliatory but uniform in all States."

You know, back then, in 1871, there was still some institutional memory of what had happened with the Articles of Confederation and why we had a commerce clause and why we were trying to have one market in the United States. Yet, here we are, as we have discussed, 136 years later, and we have seen some instances where there was some forward movement but then three steps back as different States and insurance commissioners can always back out of any common agreement. I thought you could share with us some of your observations on that.

Then you had also spoken about the particular problem with 51 different regulators that many of our military personnel face as they go from one State to another, maybe touching on the New York signature requirement and some of these other impediments to our military and to those who move, and I will turn it over to you, sir.

Mr. MCCARTNEY. Thank you, Congressman Royce.

Let me give you an example. When our military is deployed, oftentimes, they have 5 minutes or 10 minutes a week to deal with their personal financial products, if that. USAA has tried to move as much of the products and as much of the services we can to the Internet because those folks might be in a foxhole over in Iraq or Afghanistan and have one of those notebook computers and be able to try to do some things. To my knowledge, USAA is one of the few companies, if not the only, that will write soldiers while they are deployed without a medical examination, and it is frustrating to us, for example, that, as to two fellows in the same foxhole, one of them may be able to apply online and effectuate the coverage in 5 or 10 minutes, while the fellow next to him in the same foxhole cannot do that because the State Insurance Department from where he came will not allow it.

Now we are to the point where more and more States will allow it, but in the one or two or three States that do not, we do not even bother to try to get approval because we have gotten clear signals from the department that they will never approve it. So those are the kinds of things that are particularly frustrating for the military community that there are two people in the same foxhole with two different products.

Mr. ROYCE. There was another issue that I recently became aware of, and I will ask you this question about the NAIC's ability to reach an agreement with respect to international regulatory standards.

Do they have the enforcement authority over the 50 States? Because this is a common source of contention with Europe and elsewhere as we try to gain access to markets overseas and they try to gain access to markets here.

The reason I ask this is it would appear to me that there is a pretty clear disconnect between the NAIC's willingness to participate in these international dialogues and their ability then to enact any kind of meaningful legislation as a consequence. This is important because there is a letter that has been sent to the head of the NAIC's Reinsurance Task Force from the European Commission on Internal Markets, and with the approval of the Chair, I would like to insert a copy of that letter into the record.

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. ROYCE. Thank you, Mr. Chairman.

In that letter, the EU warns that, unless the Reinsurance Task Force comes up with a new proposal, there may be potentially punitive actions taken against U.S. institutions all through the EU to reciprocate for the kind of treatment for foreign institutions here in the United States. They cannot believe this fractured market, 51 separate markets here in the United States, and they are threatening action.

So I would ask you, and maybe, perhaps, Mr. Condron would like to comment, too. Are you concerned that foreign regulators may begin to take punitive actions against the U.S. entities because of the treatment their insurers and reinsurers are receiving here in the United States?

Mr. MCCARTNEY. Mr. Royce, I will defer to Mr. Condron on that because I am certainly not an expert in trade matters, but let me just point out that attachment three to the NAIC's written testimony lists the 50 largest insurance markets, and among those are—I do not know—20 States. It is a little bit misleading because the United Kingdom is listed separately. Spain is separate. France is separate. What you are talking about are those companies coming together for a single market where you are able to do business in all the European communities. So it is a little bit misleading to list them separately on this list.

Mr. ROYCE. Good point.

Mr. Condron.

Mr. CONDRON. Congressman, thank you for your support of the optional Federal charter.

I thank the Congresswoman as well.

You know, I cannot speak to what punitive action the EU would take, but I think that the main point is that the U.S. insurance industry has no common regulatory voice that can speak for it or regulatory voice that has the power to implement any decisions that they might make. I think, you know, as to all of the fine efforts that have been made by the commissioners in the NAIC, they are not unified, and they never will be, and that is part of the problem here.

Mr. ROYCE. So we have the SEC. We have the Fed. We have the OCC that all serve to get financial instruments to represent the interests of the banking industry in terms of gaining access to markets overseas, and you are speculating that the National Association of Insurance Commissioners is not going to have that same clout or seat at the table in terms of opening those markets for competition?

Mr. CONDRON. They just cannot. You know, they cannot agree on what the reserving requirements will be on universal life insurance policies, or when they do agree, they cannot get all of the States to go along, and that is the frustration, I think, Commissioner Bell and all of the commissioners have always had with the NAIC.

Mr. ROYCE. That is what is hurting our competitiveness.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much.

Mr. Scott of Georgia.

Mr. SCOTT. Thank you, Mr. Chairman.

Let me ask each of you, or whomever would answer this particular question, as we look at this issue.

How big would a national office of insurance need to be to handle the millions of consumer inquiries and complaints that State regulators receive each year?

Mr. SOTO. Congressman, I would not be able to venture a guess, but if you really think about the vagrancies that occur in every one of our individual communities, you would have to have individuals close enough to the locales and with the authority to be able to react quickly to the needs of consumers, and that appears, to me, to be a very massive undertaking. I do not know what their number is, but it will be big, and it will grow continuously.

Mr. CONDRON. I think I see a different approach.

We are doing things 50 different times right now. We are doing it over and over 50 times. So I would say the size of a national regulatory overbody, like the optional Federal charter, in the aggregate would take less people than the current State system does.

Mr. COUNSELMAN. Congressman, the OFC bill does have a proposal that suggests that there would be regional consumer offices or consumer complaint offices so that there would be a mechanism to respond. Certainly, wherever the complaints might be coming from, they need to be responded to.

Mr. BELL. Congressman, the reality of the situation today is, with market conducts and consumer complaints and inquiries that we receive, we would probably be looking at somewhere between 10 and 12 percent of the current staff members who are part of the

State regulations today that are devoted to that, and I can look at that from my own department.

Mr. SCOTT. Let me also ask you this question, and I have heard the complaint or the concern that you have 50 different States and 51 different State regulations, but if States are a legitimate regulatory entity, do you believe that States are able to make rules to comply with what that State deems important for that population and that, in effect, different regions are different with different backgrounds, with different local needs and that, perhaps, the consumer could be better served and competition enhanced with that kind of sensitivity played to those local needs and, having the independence to grow in their own way and on their own time, that that would further ensure competition within the industry?

I mean, don't you see clearly the benefits of having States' and local communities' having the most direct input that one size does not fit all, perhaps, particularly with an industry like insurance where the vulgarities of the whole Nation are so different? This is a very, very diverse Nation. Insurance is a very, very personal, grassroots entity. Even down in the South where I am from, I mean, there are different formats, but—you know, you have weather patterns. You have demographic patterns. You have so many differences. You have industrial patterns. You have health patterns that are different. In some parts of the country, people live longer than others.

So this State versus National issue, I think, needs to be looked at with a more jaundiced eye than with what we are looking at it. Wouldn't you agree?

Mr. BYKOWSKI. If I may respond to that, I felt for a minute there that you were reading from my prepared statement because, certainly, NAMIC feels that we would much rather deal with our State regulators when we have those types of issues. I can pick up the phone and call my commissioner of insurance and discuss a regulatory problem. In fact, the commissioner has called me on a number of occasions to seek input on those types of issues, and I just cannot imagine what it would be like to have to call someone in Washington, D.C., and ask him about some specific issues relating to some of the States we do business in and trying to get the types of results that we are capable of getting on a local basis.

Mr. MCCARTNEY. Congressman, if I may, for all of your constituents, if they wanted to continue to be customers of companies that are regulated by the insurance regulator in your State, that is their choice. They can do that. For others, they say, you know, "I am perfectly fine with USAA, and USAA now has a national regulator. I prefer consistency in my product and consistency and uniformity in my service. I will opt for a federally regulated company." So it does not really displace the current system.

Mr. SCOTT. But would it enhance competition—

Mr. MCCARTNEY. Absolutely. Absolutely.

Mr. SCOTT. —more than the State?

Mr. MCCARTNEY. It would facilitate companies going into new markets. It would be incredible what would be unleashed if companies had the degree of freedom to compete on forms and prices and everything else that we see in other aspects of the financial services' community.

Mr. SOTO. One of the concerns that we have is that—we are building a portfolio, we are independent agents, and I represent a number of insurance companies.

One of the concerns I have is, as we build the protection for a particular client, we may actually have their automobile with a State domestic company, the homeowners with another State domestic company but have the personal umbrella, the personal nexus, with a national company. To date, some difficulties have arisen. We have to navigate and help that client navigate that appeal. Certain appeals occur at the local level. Certain appeals occur at the Federal level, and it creates confusion and distortion for the insured.

Again, we do not want to defend—with all due respect to Mr. Bell, who happens to be a personal friend, I do not want to defend a lot of aspects of the State system. I happen to believe that we need to improve it but with specific targets.

Mr. CONDRON. I will just say, Congressman, that the things that you were referring to really do not resonate in the life business. In the life insurance business, you do have a very strong argument for uniformity across all 50 States and territories. I would say, you know, think about if the mutual fund you owned was different in your State versus in Congressman Kanjorski's, Pennsylvania. It serves no purpose.

In terms of local regulation, we already have it with the SEC's regional office and FINRA regional offices. They are very effective. They regulate us on certain things out of their New York offices. They are very effective. It is a system that actually works very well.

Mr. SCOTT. Well, let me just finalize one question if I may, Mr. Chairman. I know my time is running out.

One of the complaints of some in the industry is that it costs too much in compliance to introduce new products.

Could you give me some specific examples of new products that have not been introduced because of the cost of regulation as opposed to a business decision that a product is not competitive or profitable?

Mr. MCCARTNEY. Congressman, it is not the aspect of the cost as much as the knowledge that, in some States, you will never get approval, and so you do not even try.

When I was speaking earlier about the State that will not allow for online applications of life insurance products, we do not even try because the signals from that department are clear that it is never going to get approved, and so cost is much less of an issue than the stifling effect on innovation that the different requirements of the States have.

Mr. SCOTT. Thank you, sir. I appreciate your indulgence with your time.

Thank you, Mr. Chairman.

Chairman KANJORSKI. The gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. GARRETT. Thank you.

Thank you for the testimony of the committee.

Mr. Bell.

Mr. BELL. Yes, sir.

Mr. GARRETT. Back when I was in the State government, I had an opportunity to go and speak before a group of the regulatory and compliance officers, and when I told them what State I was from, there was just basically a groan, knowing how hard it is to file in the great State of New Jersey, not that you need to be defended; it is just in regards to Mr. Baker's comments. I appreciate what Mr. Baker was saying, and there may be truth to what he was saying there, but I think, also, the point needs to be made that some of the pushback on some of these issues as to why things do not come more uniformly is not just from the commissioners. There is an element to that, but it is also from the legislative body as well as the legislators who are hearing, in large part, from the consumer groups and the like that we retard any movement toward moving forward. We also hear from the insurance industry, certainly. Clearly, though, when the legislators move from the State level to the Federal level, we gain all wisdom, and so that is how we are able to resolve these issues on the national level.

One issue, though, that you might be able to address or the other people might be able to comment on—and I do not know the answer to this as I look to you. I am told that the States currently get almost $3 billion, $2.75 billion, in nonpremium tax revenues from insurers and producers. I know from being in State government that it all doesn't go to pay for the Insurance Department. There are often bribes to the insurance companies that we raise these fees, and then we use that for a whole bunch of other programs in the States.

If we were to go this way—first of all, that number is about right. If we were to go this way and carriers became national carriers or carriers regulated on the Federal level, would we begin to see diminution in those dollars going to the State coffers? If the answer to that is yes, then, B, what impact does that have either on the departments or on all of the other things a State usually likes to spend money on?

I will start with Mr. Bell and then Mr. McCartney.

Mr. BELL. Thank you very much.

Let me say that the State of New Jersey today is one of the legislatures that has printing legislation for the interstate compact, so there has been much changed in the State of New Jersey.

Mr. GARRETT. After I left, it got better.

Mr. BELL. But there has been.

The impact on the financial resources of the State—much of the State's resources that we use in other areas of the State come from the premium tax that we collect. The fees that we collect to run the department go in to run the department primarily, per se. If, in fact, we do not spend it, then we send some back to the general fund, but that would have a tremendous impact on the general fund budgets of all States.

Mr. GARRETT. Mr. Counselman.

Mr. COUNSELMAN. Our current bill would not address taxes. We would not replace taxes or move taxes, and States would continue to have a right to tax premiums, the OFC people.

Mr. MCCARTNEY. H.R. 3200 specifically provides that insurance companies will continue to be liable for premium taxes in every State in which they operate.

Mr. GARRETT. How about nonpremium tax revenue?

Mr. MCCARTNEY. Well, for the most part, the nonpremium tax revenue is limited to those States that have fee-based insurance departments.

Mr. GARRETT. My understanding is they are fee-based.

So the figure that I had was $2.75 billion in nonpremium tax revenue. So you are saying that there would not be a diminution for those States if those carriers became federally regulated?

Mr. MCCARTNEY. No, that is not necessarily true because, if it is a fee related to regulation, then those fees are going to be paid to the national regulator instead of to the individual States. There would be an offset in formulating the degree of regulation that is being asked of the States because it is now being done by the Federal Government.

Mr. COUNSELMAN. Congressman, they could still tax premiums, which is the other portion and the larger portion.

Mr. GARRETT. All right. The other question—and maybe we can have a comment from Mr. Condron and from Mr. Bykowski on this. It is the issue on competitiveness. I have a feeling that you two differ on what would actually happen here. One argument—well, I will make the arguments for you.

One argument is that you have greater competitiveness by the national aspect of this and—without putting words in your mouth, but you can speak to this—that now just the opposite would happen, that little guys out there would no longer be able to be in the same competitive ball game and would be squeezed out.

Can you tell me which one of you is correct?

Mr. BYKOWSKI. Well, there are 1,400 insurance companies that are members of our trade association, and almost every one of them are concerned with Federal regulation versus State. We want to maintain the State regulatory model. Many of our member companies are single State or are few State operations. There is no doubt about the competitive nature of the market in many of the these States. I will use the State of Wisconsin, as an example, with 900 companies doing business. I do not think that a Federal regulatory business model would help that.

Mr. GARRETT. Mr. Condron.

Mr. CONDRON. You may be drawing a distinction between the life business and the property and casualty business.

In the life business, I think the competitive argument is very clear. It tends not to be a local business; it is a national business, and from our perspective, it should have a national regulator. I think you have two different insurance businesses here, and I think that—you know, I would encourage you to think about it that way.

Mr. COUNSELMAN. Congressman, the commercial business has that same approach. It is a national approach. For some companies, it is national, and for many companies, it is regional, but commercial business is certainly a national approach.

Mr. GARRETT. Thank you. My time is used.

Thank you.

Chairman KANJORSKI. Thank you very much.

The gentlelady from Illinois, Ms. Bean.

Ms. BEAN. Thank you, Mr. Chairman. I have two questions. The first is for Mr. McCartney of USAA.

You mentioned that you serve the military and, in trying to serve those men and women, that uniformity would assist you in doing that. I want to point out that the NAIC points to its SERFF system as streamlining and modernizing insurance regulation. Have you worked with that system? What has your experience been relative to streamlining the process of bringing products to market to those whom you serve?

Mr. MCCARTNEY. Congresswoman, thank you, and thank you and Mr. Royce again for introducing H.R. 3200. We are very, very pleased.

Ms. BEAN. Thank you.

Mr. MCCARTNEY. With respect to SERFF specifically—and I have an example in my written testimony—from our perspective, SERFF is somewhat helpful, but not really. To a large extent, all it does is saves us on postage, mailing fees, forms individually to each State Insurance Department. There are still State-based forms. As I mentioned in my testimony, we recently made a filing that would allow for an online—an Internet—discount. By the time it was all said and done with all of the State forms, it came to over 1,000 pages. So I do not view that as being an example of significant modernization or streamlining.

Ms. BEAN. Thank you.

My second question is in relation to some testimony from July of 2006 before the Senate Banking Committee. Undersecretary Randy Quarles of the Treasury cautioned that the likely inability for individual State insurance regulators to get a firm handle on the risks that large, complex insurance companies pose to our Nation's insurance system, coupled with a lack of a Federal role in the State-based insurance regulatory system could leave a large blind spot in evaluating risks that are posed to the general economy and financial markets.

So I want to direct my question to Mr. Condron since you head up a national entity. What are your comments on that?

Mr. CONDRON. Yes. I mean, I think that is a pretty astute comment because the products that we are delivering to the marketplace today are very complex financial products that require—they require hedging. They require the use of derivative instruments, and they are very complex products to understand to figure out what kind of reserves should be put in place and to be sure that the companies that are making these guarantees are going to be here 50 or 75 years into the future to honor the guarantees they are offering to their clients.

So I think that there is a risk and that you just do not have the sophistication at the State level that you could accumulate on a national basis with the Federal charter.

Ms. BEAN. Thank you.

I yield back.

Chairman KANJORSKI. Thank you.

The gentleman from Illinois, Mr. Manzullo.

Ms. BEAN. Can I yield a moment to my good friend, Mr. Royce?

Chairman KANJORSKI. Oh, surely.

Mr. ROYCE. Thank you, Mr. Chairman.

I thank the gentlelady for yielding.

I wanted to ask Mr. Bell a question because, in going over your testimony, you cite many undertakings by the NAIC which have been adopted by a number of States. Thirty States have adopted the Interstate Insurance Compact. Thirty-three have implemented a uniform product coding matrix within SERFF. Twenty-six States are mentioned as using the P&C products requirement locator tool. I am assuming these are all successful measures.

Are you aware of any substantive measure pushed by the NAIC, in the realm of regulatory modernization, which has been adopted by all 50 States? I understand, in the past, progress has been made, and then States have dropped out because, as discussed, State legislatures will see a bill coming through. Members of the State Senate and State Assembly will say it sounds good, but in so doing, they have opted out. I was just wondering.

Can you cite an example like that where we have seen that kind of success where everybody has stayed in all 51 markets here?

Mr. BELL. Congressman, that is a great question.

The solvency issue of the NAIC that is put forth has all of the States involved in the solvency and in the accreditation process of the NAIC with the exception of New York, and I will tell you that New York at the current time is looking at going into the accreditation system. It is one where we are very, very hopeful that they will use our system even though they are using one that is comparable to the system currently.

Mr. ROYCE. Well, I will just close, Mr. Chairman, by saying that, for example, with SERFF, many States adopt the requirement, and then they add all of these additional requirements on top of the generic from which the insurer has to comply, and all of a sudden, it is different. It is different in all of these areas. So I will just close with that point. It has been a long way in coming, and I think we have a viable alternative to this, an alternative that works worldwide, which is to consider one market for the United States.

Thank you.

Chairman KANJORSKI. The gentleman from Illinois, Mr. Manzullo.

Mr. MANZULLO. Thank you.

I appreciate you all being here this afternoon. I guess I have more questions than perhaps can be answered.

I started practicing law in 1970. I have been through, probably, 1,500 to 2,000 real estate courses. The respite was passed in 1975, and the whole purpose of that was to standardize the closing of real estate transactions in the United States and to protect the consumer. It has been nothing but a total failure with HUD. Every year, we have to come in and fight HUD that wants to use a simple disclosure requirement to regulate the entire industry. I mean, I used to be able to close a transaction in 20 minutes to a half an hour. Go in there now, and you have papers like this. Look what happened to the real estate market. There is not anything in all of that Federal intervention and in all of the Federal disclosures. Nothing helped out the real estate industry, and it has been a lot worse. It has made it much more expensive to close, and no one knows what they are signing anymore. I take a look at instance after instance.

For example, we just passed the Terrorism and Risk Insurance bill, and if it were not for one man who is my constituent who heads up Rockford Mutual, all of the mutuals would have been dragged into it, and with the gracious work of Mr. Kanjorski, we exempted companies that have under $50 million in book from having to offer that particular type of insurance.

Why would we want to federalize the entire insurance industry and have hearing after hearing after hearing on some unknown, unnamed regulator? I am just really astonished that those of you—I am going to give you a hard time—who are proposing a Federal regulator did not come in here with a model. Maybe the chart would look like Hillary Care. I mean—but you cannot propose a huge, monstrous change in the manner in which insurance is regulated without having a model. You know, maybe the model is FEMA. Maybe the model is the Department of Homeland Security.

I would not trust insurance to any organization in this city. No one knows how many people would be on the board, who the regulators would be, where they would be from, what the conflict of interest would be. I mean, I can understand the argument in favor of when it comes to instruments, because they are complex, these investment instruments, and it does take time. It does take time for the States, but as I look at how regulations come about, I mean, I just wonder what was going on in the real estate industry that compelled this national takeover.

I mean, there was a national takeover in the casket business. You know, there is no interstate jurisdiction in burying somebody unless their spirit goes across State lines, and yet, they came in. Now there is this Federal disclosure when you go to a funeral home. Who looks at that? You want to get somebody planted, but somebody came into this town and said, "We need Federal regulation in order to standardize what is going on," and I find it amazing here that many of the Democrats, who are supposed to be the liberals, are arguing for federalism, and many of my esteemed conservative colleagues are arguing for the national takeover of this.

Mr. ROYCE. Will the gentleman yield?

Mr. MANZULLO. No, I have been here for 2 hours. I am not going to yield, okay?

I guess my question is: Why would you propose something unless you have a model? Give me the model Federal agency that is doing a great job in controlling. Anybody.

Mr. CONDRON. I would be happy to.

I think there are several. I think the OCC that is overseeing the banks. I think the SEC and I think FINRA, all three of which are United States Government regulatory bodies or at least are connected to the Federal Government, all of which are regulating parts of the financial services industry very effectively, very efficiently and very economically, I might also add, with local offices around the country.

Mr. MANZULLO. You know, I chaired the Small Business Committee, and there are nightmares that came up with the SEC, on different sections of Sarbanes-Oxley that we passed, that could have knocked these little guys right out of business. I mean, what I hear as a Member of Congress is that people who get rolled—especially when I chaired the Small Business Committee, it is the little guys inevitably who get rolled by the big guys, and it is over and over and over again. Now, I would entertain that, if that is possible, if you are thinking about trying to have jurisdiction attached to a product or to a group of products as opposed to an industry, itself.

For example, in the example that you gave about some type of financial product that had derivatives attached to it—I am not sure of the word that you used—I can say, well, you know, that would make sense because you want to get that to market in a hurry, etc.

You know, if you take a look at the real estate industry, sure, the brokers are licensed through the States. You go to a closing. There has been a complete federalization of the real estate closing. I mean, it has been federalized. If you want to get something changed, do you know what happens? You have to come to Washington, and you have to fight with HUD.

Mr. Soto.

Mr. SOTO. Yes, Congressman.

I will give you another model. It is FEMA and the National Flood Insurance Program, not as a good example, by the way, which you can imagine. I will tell you this.

Twenty-five years ago, I was part of a group of 12 individuals who were invited to come here to Washington to work on reforming the National Flood Insurance Program. Interestingly enough, one was the representative from USAA, and when we met here, we indicated to the FIA and to FEMA that the National Flood Insurance Program had inadequate coverage, inadequate limits, and they were not charging actuarially sound rates. They were allowing people to rebuild in coastal, fragile areas, and there was no uniformity between the private market forms and the National Flood Insurance Program.

Twenty-five years later, Katrina occurred, and the deficiencies in the coverage, specifically business interruption and additional living expense, were not there. The commentary all along the way was, "It takes an act of Congress in order to change it." We spent about 6 to 8 months coming up here. We ended up reforming how the dec page looked, and we ended up reforming the application and reorganizing the manual. The substantial important coverage did not occur because the Federal Government is not nimble, and it is not able to quickly respond. I have the same fears that you do.

Mr. MANZULLO. I have no time left, but I—does somebody else have a comment?

Mr. COUNSELMAN. Congressman, I would also like to reinforce the example in banking.

I am a director of a community bank, and we are a State-chartered bank, and we like it that way, and it works very well for us. So I think that model works for insurance as well as long as a local or a regional company has that option, which, I think, is a good thing. They should have that option. A national company, the M&T Bank in Maryland—I am from Maryland. They are from New York, but they are in Maryland. They are a national bank, and their predecessor was All First Bank. All First Bank, before it was acquired by M&T Bank, actually made a decision to change from national regulation to State regulation, and they became a State-chartered bank. So they had that option. They wanted to do that, and that is what they did, and it was a regulatory matter.

So I think the model is the banking industry, and if we operate on that model, we can do this. A regional company can do well as well as a national company which has a different interest can do well.

Mr. MANZULLO. I guess I sparked some interest. Would anyone else like to respond?

Mr. BYKOWSKI. I think it is a mistake to assume that because dual regulation works to some extent in banking that it will work in the property-casualty insurance industry. A checking account is one thing. A checking account is the same thing in Wisconsin as it is in California, but in the insurance coverages and the needs of the consumers that are served by the property-casualty insurance company vary dramatically by region, and I do not think that having to deal with the Federal bureaucracy as an option is the right answer.

Mr. BELL. It is a very good point in terms of the real estate industry.

When we look at the CMS and the products that are just going out, now the Federal side of that is looking to try to get the States back into the market conduct side of it because it has been such a disaster in terms of the way it has been rolled out to the public.

When we look at the $20 billion due from the taxpayers to the PPGC shortfall or at the $20 billion of the NFIP overrun, I mean you cannot name an insurance company that is dependent upon the taxpayers of the country to be able to keep it solvent or to pay the insolvencies when it would go out. So we have an insolvency system that nobody spoke of that is not anywhere nearly dependent upon the Federal Government as all of the Federal Government programs are.

Mr. MANZULLO. I am still open to this thing. I am just speaking out loud and thinking out loud, and I have no time left, but Mr. Royce is a good friend of mine, and perhaps we can create some time.

I yield back whatever time I have.

Chairman KANJORSKI. Thank you. We will assume you have some.

Mr. MANZULLO. Thank you.

Chairman KANJORSKI. I do want to take a moment—I know it is very common—and we practice it on both sides of the aisle here—to criticize the Federal Government and its failure to do anything correctly.

Mr. Manzullo, you brought up an interesting question of burial and that you are just trying to plant somebody. You may think that way until you get the bird flu or anthrax, and you had better be sure that person is planted uniformly and correctly, or you are going to wipe out half the population of the country.

So now, with the amount of transient capacity that we have in the United States, it is important to have uniform standards that are followed and questioned. I remember bringing the issue up. You know, in anthrax, you have to understand—I will not go into the bird flu on this, but on anthrax, the human body becomes a factory, a manufacturer, of anthrax. So, if you were successful in determining where the bodies were buried and you dug them up and you used the product within the dead bodies, you would just increase the amount of anthrax you could distribute in the country, and we do not have in the United States a uniform policy of protection of how we dispose of the bodies of people who would die from anthrax poisoning. So it is something to look at. I wanted to go on and give you an analogy.

You and I are both old lawyers. I may be, actually, an older lawyer than you are, but the other day, I was talking to one of my aides who is in law school, and I asked him how students today appreciate the Uniform Commercial Code and the Sales Act. When I said the Sales Act, his eyes glassed over, and he sort of looked at me like, what is the Sales Act? Well, you and I know, when we were in law school, we spent a year finding out what the Sales Act was about. That does not exist anymore in law schools. That is something of old England. They do not talk about the Sales Act anymore.

So, you know, we have had the uniformed commercializing of our system. It does take a long period of time. When you think about it, it probably took 30 to 40 years for the Uniform Commercial Code to permeate the business community. But I think we all have to say that the number of transactions that are held in the United States today could never have been as successfully handled under the Sales Act as they are under the UCC.

Then finally, I always point out to my friends who argue about the uniformity of the railroad gauges, that in the United States, some brilliant son of a gun decided to have a uniform gauge in the 50 States so we would not have to change our railroad cars and engines at every State line that we passed through, but in Australia, just up until 30 years ago, when you would go from one province to another, you had to stop the train, reassemble, and put new wheels on because you were going onto a new track. The lack of industrial development in Australia was phenomenal until they went through this upheaval. Of course, the problem is, the longer you wait, the greater the cost and the greater the upheaval because we all get experienced in dealing with the tried and the true.

Then, finally, I heard you damn again the failure of the Federal system. If we would just all reach in our pockets and pull out our bills, we would discover that it was not until 1914 that we had common national currency in the United States. At one time, Philadelphia was the major printer and distributor of American currency. It caused a problem if you were in San Francisco and somebody gave you a demand note drawn on the Bank of Philadelphia. You were not quite sure whether it was good or not, and it was very hard to call Philadelphia at that time since the telephone would not have been invented for another 50 years. Now we take for granted the Federal Reserve notes and how great it is to have that uniformity.

As we went through the crisis this last month, the fact that interest rates can be changed overnight and that sophisticated reaction to catastrophe—if you go back to the 1907 crisis, it almost brought the Nation down. Here—not that I am going to predict that we are over it—we are certainly much further along and in a much more involved and more sophisticated society.

So, although I have a tendency to be relatively conservative and fight change simply because I do not want to learn a new system—that is the truth of the matter—I think there is merit on both sides of this argument. Quite frankly, I am torn. One day, I wake up, arguing for a national standard to see how it could be done. Then the next day, I wake up, and I hear the echo of Mr. Soto, and I say, we cannot afford to have that happen, and we will do it in other stages.

I am convinced of one thing. There is no question in my mind that this Congress has some objectives that we should go after, and that is to simplify some of the complicated systems that are happening now. Whether we call it an "optional charter" or just how sophisticated it is or what areas we go into, I do not think we can question the argument that the country will be more competitive, will be more price conscious and probably less regulated—the industry—than it is now, and it will protect our international competition area. I think all of those things are probably important because it seems to me—again, I am not an economist, but as we do those things, we will create wealth for the United States, and I think that is probably what we are all trying to be about.

So my offer to you, as an extension to the other side of the aisle, is we will hold hands together and go down these rapids that we are riding, but I think we will make it.

I do not know if anyone has any further questions that they want to ask.

Mr. ROYCE. Well, Mr. Chairman, I will just close any commentary with one last question, and that is—I am sure that we all agree in this debate, wherever we are in the particulars, that regulation should be based on consumer protection and fair, consistent, impartial treatment of insurers' products instead of a relationship on political connections.

The question I was going to ask is: Would we have world-class regulation today over the banking system if, instead of our current system, we elected—if we elected—the Chairman of the Fed, of the OCC? Should we elect the Chairman of the SEC?

I would just ask Mr. Soto and maybe Mr. Counselman for your observations on that premise. You know where I stand. I think, for those who are in the national market, we give them an option. We allow the States to regulate on a State basis. We allow for those who want to be part of a national and an international market to have this option like the banking industry has, but I would just be interested in your observations about the efficacy of such a proposal.

Chairman KANJORSKI. I have one question before they go to that. My question to you is: Who would be silly enough to run?

Mr. ROYCE. Well, that is the problem, those silly enough to run.

Mr. SOTO. I am not sure I am qualified to delve into the part about whether the Chairman of the Fed or of the OCC or others like that should be elected or appointed, and I suspect, by the way, that you stated your question, that you are dubious on that.

I will tell you that we still perceive that insurance is different from banking. We have at the State level a number of appointed insurance regulators and a few elected. Candidly, I have discussed that issue with many people over the years and with people who have been in the business a lot longer than I have, and we find that there are good ones and there are bad ones on both sides. There are good ones who are elected and also bad ones and good ones.

So, beyond that, I am not qualified to give you a broader opinion. Perhaps someone else will.

Mr. COUNSELMAN. I agree with Mr. Soto. I would be very concerned about that position being elected, just as most States have been concerned. In most States, it is an appointed commission—the commissioner is an appointed position—and I think that is the more appropriate manner in which to regulate insurance.

Mr. ROYCE. Thank you, Mr. Counselman.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Let me ask a question while I am here, too, because I brought up the issue of creating a new bureaucracy. Is there a way to avoid creating a new bureaucracy? Maybe, Mr. Bell, I could point this to you.

Is there some way we could press into service the existing State agencies out there and just federalize them or quasi-federalize them? That is, allow them to operate as they are now on matters of issuing State licenses but operate as Federal people if they are dealing with an optional Federal charter? Could that functionally work and then have a very small office of the insurance commissioner here in Washington for Federal optional charters that would deal and implement through those State agencies?

Mr. BELL. Congressman, they told me a long time ago that I was not in the business of passing law; I was in the business of regulating. I think you would have to pass a law in that area.

Chairman KANJORSKI. But do you think it could effectively work? You know, I do not see a big advantage to spending 5 years of assembling 10,000 people down here in some big building in Washington if we do not have to do that, and it seems to me that a lot of the requests that you all are asking for here do not take a lot of bodies. It just takes a little thinking and common sense and a good computer, and it could probably be put together. I mean, the three things Mr. Condron mentioned we could do. If somebody had the authority to say, "This is an order. Do this," boom, it would be done.

Mr. BELL. We have asked and have requested, and if we go back to the Smart Act that Representative Baker was mentioning earlier, the States came for some Federal tools to do certain things, and in the end, we ended up with 37 preemptions coming out of the Smart Act.

I think that you would have to be careful in the preemptions of the States because then you would have to deal with the Governors and the State legislators there, but I think that Federal tools that are used judiciously in terms of helping the States get to—we have 30 States. If we had a Federal tool that says that, you know, "By this time, if this is not going to happen, you will become a part of the interstate compact for life, health and insurance annuities and products that are more of a national kind of product," that would go a long ways. If we had a—

Chairman KANJORSKI. We can do that along with creating an optional charter. We are capable of writing down conditions and saying to these other 20 States, "You have had enough time, and we are going to tell you that, in so many years, you are either going to do this or you are going to get an optional Federal charter imposed on you or be put out of business."

Mr. BELL. There is always going to be a disincentive as to why you do not want to go on the other side of it, and I think that you certainly have something there. The Federal database—

Chairman KANJORSKI. Yes. I am going to tell you that I am as frustrated as Mr. Baker was when he indicated this. He and I have been working on this thing for many years. We are starting to grow gray beards, thinking that this was all going to come about and in listening to representatives of your body tell us we are just a few years away. I am now convinced that, without some coercion from the Federal Government, you are just not going to get those other 20 States, and I am not sure if I were in California or in New York or in Texas that I would join you either. California is the seventh largest Nation for doing insurance business. Why would they want to get involved with all of these other States?

Mr. BELL. Well, we are happy to say that legislation is in New York currently on the interstate compact, and we think that there will be some movement in California on it also.

Chairman KANJORSKI. So you think that we should look at the possibility of putting a final time frame out there and say, "Do it or else you are dead?"

Mr. BELL. That would certainly help the NAIC and State regulations go a long way in terms of modernizing the system and the reform of the system that, I think, the industry is looking for. Yet, it would still leave, certainly, the solvency and the consumer protection issues in the hands of the State.

Chairman KANJORSKI. What do we do when Lloyd's of London comes to visit me and tells me that they are solvent and that they want to get in, in a big way, in reinsurance and in the terrorism field but that they are sick and tired of having to deposit $18 billion into the Bank of Citicorp or of New York as their proof of capacity to perform?

I mean, those guys are a little antsy about their 250-year history in the insurance business. They think they have a credibility factor built up there, and they do not particularly like the way they get treated by the kids over the pond. Isn't that something that we have to attend to if we are going to do business in the EU or if we are going to do business in Asia?

Mr. BELL. The meeting that prompted the letter that Congressman Royce has entered into the record today was a meeting that I was having with Commissioner Greeley from the EU, and it was the issue that we were talking about, and that was the reinsurance collateralization issue.

There has been much talk on the reinsurance collateralization issue, but understanding the transparency of many schemes in the world in terms of regulations is not nearly as transparent as it is here in this country. When we look at certain countries, Lloyd's is in a unique position. Lloyd's is not a company, Lloyd's is a group of names; so—they don't have an entity that is a company, so it has made it very difficult.

When you look at other companies in the reinsurance business, they have been able to—Swiss Re, Munich Re—they have been able to transition the market into the United States on a much better basis than having to go through, because they have been able to put a domicile company here in the United States.

The collateralization issue is not just unique to the United States. They require collateralization in France on some of these issues. There is a reinsurance directive going on now in the EU that has been worked on for some time and still is not in place.

The Solvency Two issue that has been put forth, they have been working on that since about 1999, and expect it to be in place by 2012. I mean, so it is not an easy transition going from one solvency scheme to another solvency scheme.

We have a task force that I have directed at the NAIC that we will look at a scheme in reinsurance collateralization that will provide that a company with a proper transparency regulatory system, the proper capitalization, the company will be able to get to zero reinsurance collateralization. And I think that is what the EU is looking for.

We had a recent dialogue with the EU just this past Sunday here in Washington with the NAIC, in conjunction with the NAIC meeting. That meeting is setting some tones for where we are going forward.

Chairman KANJORSKI. Very good. I am going to let Mr. Scott ask a question, but first, would it be fair to say—listening to all your testimony and your responses to some of the questions—that everybody at this table agrees that Congress should be working on doing something legislatively, regardless of what we call it? That there is some role that we have to help solve the problem that we have in insurance regulation in this country?

Is that reasonable to say? Does anybody object to that?

Mr. COUNSELMAN. We agree.

Chairman KANJORSKI. That is good. Everybody agrees. We have a green light from the table. We can do anything we want, Ed.

Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman, for letting me ask another question. But I would love to put it on the table to get a response, because I think it is at the crux of what we need to do, because protection of the insurance consumer is of the utmost consideration—and particularly you, Mr. Bell, and I think, Mr. McCartney, who represents the agents, to respond to this, and others, if you can.

But given the fact that that is our primary concern, where are the components within the State system, if any, that we need to fix that do, in fact, jeopardize any protection for the insurance consumer? Are there any areas under the current system at the State level that we need to address that jeopardize any protections for our consumers?

Mr. BELL. One of the major problems that we currently see, and that is, Alabama has some coasts, in terms of being a coastal State; and one of the areas that we are looking forward to is trying to make sure that we have a stable, available market in coastal properties. We have that from Maine to Texas currently.

The market has moved very drastically in terms of the modeling that it is doing in terms of how it looks at future disasters, coming forward. And this has certainly been since 2004–2005 that one of the major concerns that we have as regulators today in those coastal States is making sure we have available markets there, that it is not going to shut down the economic drive of the States in those markets. Because 50 percent of the people in the United States want to live within 50 miles of a coastline, so that is driving a huge economic piece there. So it is very incumbent upon us to come up with a scheme that will allow us to make sure that those markets are stable, available, and affordable.

Mr. SCOTT. And you are moving on those schemes?

Mr. BELL. Yes, we are, sir.

Mr. SCOTT. Yes, sir.

Mr. BYKOWSKI. If I may, I think that if there was one single issue from a regulatory perspective that would be most helpful to all consumers would be the deregulation of pricing in the States. We see in those States that have heavy rate regulation, we have an availability problem. Consumers have a hard time finding reasonably priced insurance, property casualty insurance.

Those States that have the free market and the file-and-use systems where the regulators are not nitpicking on the pricing, but insurance companies are allowed to price their products based on the risks that they are underwriting and that they see, the choice for the consumers is much better.

Mr. CONDRON. A quick example: We introduced long-term care as a rider on our life insurance contracts, and we can't get long-term care approved in somewhere around 20 States at this point. And I mean, that is—talk about consumer protection, you know, that violates the ability of people to be able to access something that they desperately want to be able to buy.

Mr. SCOTT. Okay.

Mr. COUNSELMAN. Congressman, I would add, any availability and affordability issue, from a sales point of view, for the customer is important. And I would say that difficult lines of insurance for availability and affordability typically are, as Commissioner Bell has just addressed, the coastal areas in particular. And whenever we have a risk that is in a coastal area, it is difficult to place.

And then, in a totally different area of insurability, it is health insurance, particularly for a small group. And that tends—that is a State issue, as forms are different and requirements and rates are different in different States. But it is an issue that needs to be solved.

Mr. BELL. Point of clarification, and that is that to my colleague, that long-term care is a product that has had serious problems in terms of the ratings, in terms of the pricing. Fifteen years ago when it was a huge, hot product, it was underpriced. And there have been substantial increases that we have had to pass along to the consumers to get it to where it is going to be a viable product going forward.

So there are some real serious, complex issues in terms of looking at long-term care.

Mr. CONDRON. I recognize that, but our product that we are trying to get approved just accelerates the payment of the death benefit to use it for long-term care, and we can't get it approved. So it is a little different than what you are talking about, Commissioner.

Mr. BELL. And we are looking at that product very seriously right now in the viatical settlement model that we have just approved.

Mr. SOTO. Yes, Mr. Chairman. I am originally from Cuba, and I came as a political refugee in 1960. In Spanish we have an expression, "El mango bajito." El mango bajito translates, "Go for the low hanging fruit," and if you listen to our testimony here today, we all agree that reforming surplus lines and reinsurance has been a great success, that that worked very well as a targeted measure.

If we just listen to Commissioner Bell say that he would welcome—his organization would welcome tools that would help them bring about the rest of the States, and it doesn't have to be the full—the full OFC solution, but he is looking for targeted tools to help bring along his brethren States. And it would seem to me that in looking for what areas or what roads to go down, go down el mango bajito.

Chairman KANJORSKI. The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

Well, we just had the Big I tell us we ought to go for the low-hanging fruit. Mr. Condron, should we go for the low-hanging fruit as a first step and then see where we go? Would you actually oppose a bill that went after the low-hanging fruit?

Mr. CONDRON. I would, because I think—I would oppose it, because I think it wouldn't solve the problem. We would be back here, you know, trying to chip away at this, one little piece at a time, when a comprehensive solution is the only logical way to go at this problem.

Mr. SHERMAN. Mr. Counselman?

Mr. COUNSELMAN. Congressman, I absolutely agree that low-hanging fruit will never get us to where we need to be in this economy.

Mr. SHERMAN. And you don't want to harvest that first and then—

Mr. COUNSELMAN. We need to go after the big issue, and that is how we regulate in this economy. It has to be different. And I think the NAIC has a lot to offer, and we could use a lot of what they have already built. But we have to take the bigger view in order to get what we need.

Mr. SHERMAN. Let me play devil's advocate for a second.

Say, okay, you guys who advocate a Federal charter have done such a wonderful job, why don't we only allow a Federal charter? Why should we allow insurance companies to pick whether they want to live under a Federal standard or pick to move to any of the 50 States where they could have a low standard?

Is there anyone here that supports an exclusive Federal charter, by a show of hands?

Let the record show that no hands went up.

Mr. McCartney, if you are for an optional Federal charter, why not an exclusive Federal charter? Why should insurance companies be able to pick? I don't get to pick which set of rules or laws I comply with; I am pretty much stuck with one set.

Mr. MCCARTNEY. It is a model that has worked a long time for the banking industry, and it has worked very well for the banking industry.

Mr. SHERMAN. Well, it has worked for the banking industry. Some would argue that the banking industry has not done a good job by consumers, that—I mean, letus put it like this: Talk to any of my constituents who have recently gotten an overdraft fee and tell them we want to regulate insurance companies just like we do banks.

Other than that, I mean, we have a single Federal system for a whole lot of other areas. They work well. Why should we pick the banking industry? Why not pick the securities industry? Why not pick the arms export control regulation regime? Why do we pick banking as our model?

Mr. MCCARTNEY. The State-based system of regulation has been around for 130, 140 years. This would be the least disruptive model of anything that is being considered.

Mr. SHERMAN. Mr. Soto has the least disruptive model.

Mr. MCCARTNEY. No, actually, in many respects, this is much less disruptive than that, because one of the things you are talking about is Federal standards; and so the Federal Government would then dictate to the States what they would have to do, and at least in this case, the States could continue to regulate the business in their States that is under State regulation.

So it would be less disruptive than any of the other alternatives.

Mr. SHERMAN. Let me tell you about a little problem I have. I am from California. My voters voted for Prop 103. They voted for it by a narrow margin—well, by a moderate margin; and then a year or two later decided they really loved it.

Am I supposed to go back to my constituency and say, I have acted at the Federal level to, in effect, repeal the protections that Prop 103 gave to, particularly, automobile insurance customers, Mr. Counselman?

Mr. MCCARTNEY. No, because those protections would still be in place for consumers in California who want to deal under that system.

For USAA members—

Mr. SHERMAN. Let us put it like this: Folks from the industry have already said you are not really in love with rate regulation, and so wouldn't every company selling automobile insurance in my State get a Federal charter as opposed to a rate regulation charter? Do you know any company in your industry that wants rate regulation and would therefore opt for the California charter?

So basically my people all voted for rate regulation, and then I come here and I vote for a national Federal charter, and then they don't get rate regulation.

Mr. MCCARTNEY. I am sure there will be some insurance companies continuing to do business. I know of a couple of national insurance companies that deal in automobile insurance that are opposed to the optional Federal charter proposal. I would assume they would stay regulated by the States and continue to do business in your State.

Mr. SHERMAN. Not if some of the people I know got themselves elected insurance commissioner in my State. We change that every

4 years. Trust me, I know some up-and-coming politicians who would assure 100 percent Federal charter should they be elected.

I believe my time has expired. As you can tell, I am kind of with the chairman here. I want to see some reform, and I don't know how much fruit we should try to harvest.

Chairman KANJORSKI. First of all, I thank the panel. I think it has been a great panel. I certainly enjoyed it. Every time I have a hearing on this, I learn a little bit more.

As Mr. Baker said, we have had maybe two dozen of these things. So after four or five dozen, we should probably be very experienced, and be ready to go in about 2035.

But with that, we will close the hearing. The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

I now ask unanimous consent that the statement of the National Association of Professional Insurance Agents be submitted as part of the record. Without objection, it is so ordered.

There being no further business, this hearing is adjourned.

[Whereupon, at 5:40 p.m., the hearing was adjourned.]

A P P E N D I X

October 3, 2007

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON "THE NEED FOR INSURANCE REGULATORY REFORM"

WEDNESDAY, OCTOBER 3, 2007

We meet this afternoon to review and discuss the need for insurance regulatory reform. Now that we have completed our initial work in the House on extending the Terrorism Risk Insurance Act for a second time, I am pleased that we can finally turn our attention to another important insurance issue.

This hearing is the first in a series that we will convene on insurance regulatory matters during the 110th Congress. Although we have already reviewed this topic in a variety of ways during about two dozen hearings since the start of the decade, approximately one third of the Members joined the Capital Markets Subcommittee this year. This hearing therefore will give them an opportunity to begin to learn the issues. It will also provide veterans of our panel with a fresh look at these matters.

The vast majority of interested parties in the debate on insurance regulatory modernization, myself included, agree that there is no longer a question of whether or not to pursue reform. The question we must answer is how best to achieve this reform. To do so, we must start at the beginning and establish in this Congress a better appreciation of the industry's needs, a clearer understanding of recent developments in the domestic insurance marketplace and world stage, and an enhanced awareness of the policy underpinnings of the industry's existing regulatory structure. A careful examination of these points will help to lay the groundwork for any decisions that the Capital Markets Subcommittee will make in the future.

On this point, I want to explain briefly my plan for the process by which we ought to proceed to consider insurance regulatory reform. Today, we will hear from a number of key participants in the insurance industry, including the regulators, on the need for regulatory modernization. In their oral testimony, I hope that our witnesses will confine their remarks to their experiences in the current system and any new developments in the insurance industry. I am also curious to know if any recent changes point in favor of or against pursuing certain regulatory reforms.

Because many others asked to testify today, we will hear additional perspectives on the need for reform in a subsequent hearing or future hearings. This issue is important and complicated. The imposition of the federal government in some form into an area traditionally regulated by the states has enormous implications for insurers, businesses, and consumers. Therefore, we should not rush ourselves into considering reform legislation.

After establishing a need for reform, we will begin to explore policy options for reform. During those hearings, we will hear from a number of stakeholders representing a variety of views on generic reform options. Additionally, we will almost certainly convene separate hearings at some point on discrete issues like solvency protections, enforcement systems, product approval, and best practices for reform implementation.

Before moving to finalize any legislation, I would additionally envision that we will create bipartisan, Member-driven task forces to study targeted issues related to insurance regulatory reform and put together recommendations for a bill. These task forces should help us to reach a consensus. I invite my colleagues to let me know of their interest in leading and serving on these task forces.

With a solid understanding of these complex issues, this Subcommittee and eventually the U.S. Congress can make meaningful, well-thought-out reforms. This process is not a sprint. We need to review these issues and the potential consequences of changes to the industry, consumers, business, and the general public.

Let me be clear: I have no battle plan, no axe to grind, and am open to considering all points of view. I may have inclinations toward pursuing certain reforms, but I have made no final decisions about how to implement such reforms and how to build a broad consensus that garners the support of many, not just a slim majority. I plan to work through the issue step-by-step.

In reviewing the testimony of our witnesses today, I know they all hold strong opinions on which reforms might best accomplish their particular goals or undermine their perceived competitive advantages. American businesses and families rely on insurance daily. It is our job in Congress to balance the needs of consumers to have the most innovative and worthwhile insurance products on the market against the economic stability and efficiency of the insurance markets.

In closing, I am optimistic that through careful deliberation and hard work, we can identify a genuine consensus about how best to achieve regulatory reform in the insurance marketplace. I am also appreciative of the work of my Ranking Republican Member, who joined me in sending out the invitations to our witnesses. It is my hope that bipartisanship will continue to guide our work in this area in the months ahead. I also look forward to an open dialogue today.

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:
"The Need for Insurance Regulatory Reform"

Wednesday, October 3, 2007

Walter Bell
Alabama Commissioner of Insurance
President, National Association of Insurance Commissioners

Testimony of Walter Bell
Alabama Commissioner of Insurance
President, National Association of Insurance Commissioners

Introduction

Chairman Kanjorski, Congresswoman Pryce, and Members of the Subcommittee, thank you for inviting me to testify before the Committee on the need for insurance regulatory reform.

My name is Walter Bell. I am the Commissioner of Insurance in Alabama. I also currently serve as President of the National Association of Insurance Commissioners (NAIC). I am pleased to be here today on behalf of the NAIC and its members to update the Subcommittee on our ongoing, successful efforts to improve the state system of insurance supervision.

Having served as the front line of U.S. insurance regulation for over 150 years, state insurance officials have a record of consumer protection and industry oversight that is second to none. We take seriously our responsibility to ensure that the safety net of insurance is there when people need it. We have been a powerful advocate for insurance consumers, combining state-of-the-art databases and strong solvency regulation to ensure each and every consumer maximum protection. The current insurance regulatory scheme is strong, and equal if not superior, to the insurance regulatory schemes in place in other countries. State insurance regulators—along with other state and federal financial regulators who focus on fair tax treatment, improved corporate governance and increased transparency—work to produce a vibrant and competitive global marketplace for U.S. insurers.

Still, there are those who would claim an expanded federal presence is needed as an alternative to state consumer protections. They say a centralized authority that would offer deregulation to deal with a perceived "hodge-podge" of state governments and bring insurance regulation into the 21st Century. Mr. Chairman, Congresswoman Pryce, Members of the Subcommittee, I submit: State insurance regulation has been and continues to be a dynamic and robust success.

My testimony today will focus on state efforts to improve insurance regulation for U.S. consumers and industry. That has not occurred in a vacuum. The NAIC, and state insurance regulation in general, underwent serious review on Capitol Hill and in state legislatures in past decades. Major companies were going insolvent, policyholders were going unprotected, insurance scams were numerous, and state regulators—whether they deserved it or not—were seen to be asleep at the switch.

Congress held hearings—lots of hearings—detailing laxity and even corruption at the state level, criminals crossing state lines with impunity ("rascals and scoundrels," in the words of a once-and future Committee Chairman) and a regulatory scheme that appeared inconsistent at best, inept at worst.

The hearings culminated in two Committee reports that provided a permanent record of the perceived weaknesses of the state system of insurance regulation. They did not prove to be very pleasant reads for those tasked with overseeing the insurance industry and its various players, just as the allegations aired at the hearings were not easy to listen to.

But listen we did. And we acted.

State insurance regulation in 2007 is robust, effective and constantly evolving to better reflect the changing marketplace and better protect consumers. Where we may have been accused of being weak and passive fifteen or more years ago, we are today strong and effective.

I want to cover a number of major initiatives the NAIC has undertaken with state insurance regulators in recent years. We have been the face of regulatory reform, coupling an aggressive enforcement mindset with advanced techniques to provide comfort to American consumers in times of peril. My testimony will cover a number of major areas where we have taken the initiative and successfully strengthened the state insurance regulatory process.

- Speed to market;
- Solvency and guaranty funds;
- Consumer assistance and education;
- Fraud detection;
- Regulatory actions against companies, agents and brokers;
- Turnaround on rate and form filings;
- Producer licensing; and
- Company licensing.

Speed to Market

Insurance regulators have embarked on an ambitious "Speed to Market Initiative" that encompasses the following four main areas:

- Putting in place an interstate compact to develop uniform national product standards and provide a central point of filing ;
- Integrating multi-state regulatory procedures with individual state regulatory requirements;
- Encouraging states to adopt regulatory environments that place greater reliance on competition for commercial lines insurance products; and
- Making fully available a proactively evolving System for Electronic Rate and Form Filing ("SERFF") to achieve speed to market goals.

The Interstate Insurance Compact ("the Compact") is a key state-based initiative that allows insurers to file new life insurance, annuities and other wealth-protection insurance products and receive a single, streamlined review. This vital reform allows insurers to speed new products to market nationally according to strong uniform product standards, while preserving a state's ability to address front-line problems related to claims settlement, consumer complaints, and unfair and deceptive trade practices. States have embraced the Compact and have been speedily enacting it. To date, thirty states have implemented the Compact—representing half of U.S. nationwide premium volume—and more are in the process of doing so. It is worth noting that some of the states that have not yet joined the Compact have not been lobbied heavily to join because their product approval process is so rapid and efficient that it would be nearly impossible to improve.

The Compact created the Interstate Insurance Product Regulation Commission ("the IIPRC") when it met its threshold of 26 Member States and/or 40 percent of premium volume in May 2006. It became fully operational earlier this year and reviewed and approved the initial filings in under thirty days - a dramatic demonstration of providing speed to market while upholding strong consumer protections.

The uniform standards-setting process at the IIPRC is conducted through comprehensive public notice and comment periods that afford full opportunity for input to industry, consumers and the general public. The compact ensures that products can quickly enter the market while ensuring that those products have appropriate protections in place.

The NAIC has developed a set of uniform metrics based on the four operational efficiencies listed previously. SERFF already has the necessary accounting and reporting framework for both paper and electronic product filings, and has been implemented in all states.

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. Most states have developed and posted Review Standards Checklists to their state websites, which in turn may be accessed by all insurers through the NAIC's website. Insurers taking advantage of this regulatory modernization have found a dramatic increase in the likelihood for successfully submitting a filing, thus vastly improving speed to market.

The product requirements locator tool is available to assist insurers in locating the necessary requirements of various states when they are developing products for use in multiple states. Twenty-six states are using the property and casualty products requirement locator tool, with six more in the process of implementing it. Most jurisdictions are on pace to implement the life and health product requirements locator tool by the end of 2008.

The NAIC has developed product coding matrices to provide uniformity in naming and coding products. This will enable insurers across the country to communicate seamlessly with insurance regulators regarding product filings. To date, 33 states have implemented the Uniform Product Coding matrix within SERFF for all lines of business and an additional fifteen states are implemented for at least one line of business and working on full implementation.

The NAIC has developed Uniform Transmittal Documents to permit uniform product coding, so that insurers across the country can code their policy findings using a set of universal codes without regard to where the filing was made. The multiple codes developed historically by individual states for their own lines of insurance have been replaced by a set of common codes so that insurance companies no longer need to keep separate lists of codes. With the release of SERFF v5, to be discussed in a later section, 33 states have completely eliminated use of alternative transmittal documents and seventeen states have eliminated requirements for alternative transmittals for some lines of business and are working on elimination for all lines.

Solvency and Guaranty Funds

State insurance departments in the past fifteen years have continually enhanced their statutory authority and regulatory practices in this critical area. Major insurer insolvencies in the late '80s and early '90s, coupled with inadequacies in several state guaranty funds, stirred Congressional interest and led to cries for federal intervention. Due to action by state regulators, there has been a dramatic reduction in major insolvencies since that time.

Notable improvements by the state departments include:

- Codification of accounting practices into one comprehensive manual, resulting in consistent and comparable financial statements;
- Enhancement of financial reporting requirements on an annual and quarterly basis of key areas, including reinsurance, investments, reserves, significant disclosures and off-balance sheet risks;
- Refinement and development of analytical tools to provide state insurance regulators with an integrated approach to screening, prioritizing and analyzing the financial condition of insurers operating in their respective states;
- Strengthening of existing statutory authority, such as risk-based capital requirements, examination authority, investment regulations, reserving statutes, actuarial opinion guidelines, receivership and guaranty fund schemes and frameworks, and holding company considerations (including provisions regarding acquisition of control or merger);
- Enhancement of financial examination and analysis procedures and guidelines to be more risk-focused to better target resources and regulatory efforts; and
- Establishment of a more efficient company licensing process through the development and implementation of the Uniform Certificate of Authority application and an electronic tool for creating and submitting the applications.

Ultimately, these improvements have allowed regulators to identify more easily when insurers are troubled and react more quickly to protect policyholders and consumers.

Attachment 1 details more specifically the NAIC's efforts to continually improve the solvency framework used by all states.

Consumer Assistance and Education

With the many changes taking place in the financial services marketplace, consumer protection poses significant challenges to a regulator. I am happy to say that state insurance regulators have risen to the challenge. Insurance is a unique and complex product that is fundamentally different from other financial services, such as banking and securities. Unlike banking products, which provide individuals up-front credit to obtain a mortgage or make purchases, or securities, which offer investors a share of a tangible asset, insurance products require policyholders to pay premiums in exchange for a legal promise. Insurance is a financial guarantee to pay benefits, often years into the future, in the event of unexpected or unavoidable loss that can cripple the lives of individuals, families and businesses. The cost to insurers to provide those benefits is based on a number of factors, many of which are prospective assumptions, making it difficult for consumers to understand or anticipate a reasonable price. Unlike most banking and securities products, consumers are often *required* to purchase insurance both for personal financial responsibility and for economic stability for lenders, creditors, and other individuals. Insurance products are bathed in the public interest and responsibility; they inevitably touch a host of important and difficult issues whose impact is felt locally. Most consumers find themselves concerned with their insurance coverage, or lack thereof, only in times of crisis—such as illness, death, accident or catastrophe. State officials have responded quickly and fashioned effective remedies to respond to local conditions in the areas of claims-handling, underwriting, pricing and market practices.

The NAIC provides a forum for education and information exchange, with more than 64 courses on a variety of insurance topics, and eighteen programs designed specifically for insurance regulators. In 2006, the NAIC launched the Insurance Regulator Professional Designation Program to enhance regulators' skills, techniques and strategies for monitoring the insurance marketplace.

The NAIC has been proactive in ensuring that state insurance regulators have the very latest and best tools to educate consumers on important insurance issues. These have included outreach campaigns, public service announcements and media toolkits. With its landmark *Insure U—Get Smart about Insurance* public education program, (www.insureuonline.org) the NAIC has demonstrated its deep commitment to educating the public about insurance and consumer protection issues. Insure U's educational curriculum helps consumers evaluate insurance options to meet different life stage needs. Available in English and Spanish, the Insure U website covers basic information on the major types of insurance—life, health, auto and homeowners/renters insurance. It also offers tips for saving money and selecting coverage for young singles, young families, established families and seniors/empty nesters. There is a quiz for each life stage, enabling consumers to test their knowledge on insurance issues and topics. We have produced a new TV public service announcement, tailored to each state and providing contact information for the state insurance department, warning consumers how to protect themselves from fraudulent insurance schemes. Consumers may also call a toll-free telephone number to find consumer representatives in their home state insurance departments. Already, more than forty stories about Insure U have been carried by AP, Reuters, UPI, The Wall Street Journal, The Washington Post blog, the Atlanta Journal Constitution, The Chicago Tribune, The New York Daily News, and various other newspapers. Additionally, eleven radio interviews on Insure U aired on CNN radio and local stations in Connecticut, California, Missouri and Arizona, reaching over a million listeners in that medium alone. Collectively, Insure-U's public outreach has registered 158 million media impressions.

Fraud Detection

In January 2005, the NAIC launched an online fraud reporting mechanism to allow consumers, employees, or others who suspect wrongdoing to report their suspicions anonymously to state enforcement authorities. Since business practices in one state may be connected to problems in other states, the system allows for focused fraud detection in close proximity to where problems arise. Continued regulatory collaboration avoids duplicative and excessive data requests that delay responses from the producer and insurer industries and hinder appropriate state regulatory action.

Regulatory Actions Against Companies, Agents and Brokers

Although not law enforcement agents in most states, state regulators do effectively prevent unfair trade practices as part of their supervisory authority. Every state has laws in place to address unfair trade practices, giving the insurance regulator ultimate authority to investigate a variety of unfair practices, impose fines and require appropriate corrective actions. For example, the Trade Practices Law in my state of Alabama prohibits unfair methods of competition as well as unfair or deceptive acts in the business of insurance, including benefits, unfair claims handling procedures and other fraudulent practices.

State regulators' primary responsibility is to maintain the stability of insurance markets and products for the benefit of consumers. Conscientious and highly skilled regulatory professionals monitor the business activities of insurers every day to assure that the companies have the financial wherewithal to make good on their promises and treat their policyholders and claimants fairly.

State insurance officials actively supervise insurers' market conduct through market analysis, periodic examinations and investigation of specific consumer complaints. Consumers having problems with their homeowners, health, automobile or life insurance can readily contact state insurance regulators by email, telephone, regular mail and personal visits. State regulators earn consumer trust because they know the cities, towns and communities where consumers live, as well as the nuances of the local insurance marketplace.

Insurance products are complex financial instruments, and therefore difficult for many consumers to understand. Working together, regulators and responsible business participants help to strengthen financial stability and fairness in the marketplace. State insurance regulators' extensive daily monitoring of solvency, review of rates and policy forms, and evaluations of market behavior, coupled with state attorneys general enforcement of state antitrust laws, have produced a vigorous and active insurance regulatory scheme providing maximum consumer protection.

Given their primary role in the protection of insurance consumers, state insurance commissioners take pride in the historical fact that state-based regulation works very well to provide consumers with a healthy marketplace and confidence that the basic obligations set forth in their insurance policies will be met. When the marketplace functions without significant problems, it means that we are working successfully to protect consumers by maintaining competitive and stable insurance markets.

A recent example demonstrates this well. Following more than a year of analysis by the New York Insurance Department, the state attorney general's office in October 2004, obtained a number of indictments and guilty pleas against a large brokerage firm for bid-rigging and other fraudulent activities.

The system of active state insurance supervision worked. Existing state consumer protection, antitrust and unfair trade practice laws provide the necessary tools and enforcement mechanisms to stop anticompetitive conduct. Without admitting or denying the allegations against them, several of the nation's top brokerage firms and major insurers entered into consent agreements with a number of attorney generals and state insurance departments. The agreements establish settlement funds ranging from $2 million to $850 million, from which payments were made available to policyholders.

For a more detailed review of state and NAIC actions regarding antitrust violations related to producer compensation, please refer to Attachment 2.

Turnaround on Rate and Form Filings

The NAIC's System for Electronic Rate and Form Filing ("SERFF") provides a single point of filing for insurance products, and is the filing system used by the IIPRC. Insurers choosing SERFF to file their products experience a considerably shorter turnaround time for the entire filing submission and review cycle than is possible under the traditional paper filing process. Some SERFF filings are turned around in a single day. SERFF is currently being used by all fifty states, the District of Columbia, Puerto Rico and over 2,600 insurance companies. Insurers' use of SERFF has grown tremendously in the last five years, with more than 270,000 filings submitted for review and approval during 2006.

Late last year the NAIC released SERFF v5, unveiling new functionality and expanded filing options. Following this release, eleven states have mandated, or announced plans to mandate, the use of SERFF, and more states are considering doing so. As mentioned earlier, SERFF v5 has succeeded in making the Uniform Transmittal Documents accessible to all jurisdictions.

Producer Licensing

By developing and utilizing electronic applications and databases, state insurance officials have created much greater efficiencies in licensing and appointing insurance producers in those states that require it. State insurance officials remain deeply committed to achieving greater uniformity in the producer licensing process, demonstrated by the Standard Uniform Producer Licensing Application now used in every state. An overwhelming majority of states now accept non-resident licensing applications electronically.

The National Insurance Producer Registry (NIPR) is governed by a 13 member board of directors that includes state regulators and industry. NIPR developed and implemented the Producer Database (PDB) and Electronic Appointments/Terminations.

The PDB is a state of the art electronic database that links state regulatory licensing systems into one common repository of producer information. The PDB also includes data from the Regulatory Information Retrieval System (RIRS) to provide a more comprehensive producer profile. The key benefits of PDB are:

- Financial/Time Savings
- Reduction in Paperwork
- Real Time Information
- Verify License and Status in All Participating States
- Ease of Access via the Internet
- Single Source of Data vs. Multiple Web Sites

The NIPR Gateway is a communication network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information. Data standards have been developed for the exchange of license application, license renewal, appointment and termination information. The key benefits of NIPR Gateway are:

- Reduction in paperwork and data entry
- Development of national standards regarding electronic transmission of licensing data
- Faster turnaround time

The NAIC has formed a Producer Licensing Coalition to create a partnership of state regulators and national producer trade associations to fully implement national uniform producer licensing standards. While the NAIC has made great progress in implementing these standards over the past few years, we think it is time for the producer trade organizations to make a stronger contribution, such as:

- Finalizing agreement on what our uniform licensing standards should look like and promoting their implementation nationwide; and
- Developing national professional producer standards intended to help producers "walk the talk" in representing themselves as professionals in serving the needs of insurance consumers across the country.

We are also embarking upon a national self-assessment of the states continued compliance with the reciprocity provisions of the Gramm-Leach-Bliley Act, as well as measure our progress and identify any barriers to full implementation of the national uniform licensing standards developed by the NAIC. By performing on-site reviews of state producer licensing functions, we will validate these processes are working as intended, identify any areas for improvement, and document best practices for incorporation into a national handbook.

Company Licensing

To simplify insurers' application process for state licenses to write insurance, the NAIC has developed a Uniform Certificate of Authority Application ("UCAA"), an electronic system designed to help navigate state-specific requirements. We will continue to leverage information technologies and rethink our processes to make business expansion more efficient, while keeping our focus on protecting consumers from rogue insurance management.

Insurance: A Unique Financial Product that is Regulated Effectively by the States

Paying for insurance products is one of the largest consumer expenditures of any kind for most Americans. An average family easily can spend over $7,000 each year for auto, home, life, and health insurance coverage. This substantial expenditure—often required by state 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 personal stake in making sure that insurers keep their promises.

Insurance is based upon a series of subjective business decisions, many local rather than national in scope: Where does the policyholder reside? Is the insured property subject to earthquakes or hurricanes? How close is the nearest fire department? What is the policyholder's risk of civil liability under the laws of the state? Will an insurance policy be offered to a consumer? At what price? What are the policy terms and conditions? What is the structure of the local hospital and physician marketplace? 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 in turn requires a high level of regulatory expertise, accountability and responsiveness.

Every day, state insurance departments make certain that insurers meet the reasonable expectations of American consumers, including those who are elderly or low-income, with respect to financial safety and fair treatment. In 2006, state insurance departments handled approximately three million consumer inquiries and complaints nationwide, many of which were resolved successfully at no cost to the consumer. The states also maintain a system of financial guaranty associations that cover policyholder losses in the event of an insurer insolvency. The entire state insurance system is authorized, funded, and operated at absolutely no cost to the federal government.

States Oversee a Vibrant, Competitive Insurance Marketplace

In addition to successfully protecting consumers, state insurance officials have proven adept stewards of a vibrant, competitive insurance marketplace. The insurance industry in the United States has grown exponentially in recent decades in terms of the amount and variety of insurance products and the number of insurers. In 2006, there were 7,660 domestic insurers operating in the United States (an increase of more than 1,000 companies from 2004), with a combined premium of $1.409 trillion. As a share of the U.S. economy, total insurance income grew from 7.4 percent of gross domestic product in 1960 to 11.9 percent in 2000. In 2005, while insurance companies were absorbing record losses, they were also making record profits. Profits and surplus increased again in 2006, and the industry is on pace to set yet another record this year. Insurance company surplus is now over $500 billion for the first time ever.

Although these national numbers reflect a large industry, most insurers and most of the nation's four million insurance agents and brokers operate in three or fewer states. Even the giants of the industry use slogans that imply a close-knit local flavor such as "Like a good neighbor" or

"You're in good hands."

Today, companies of various sizes sell a vast array of products across state and national boundaries, reflecting the growing national economy and diversity of buyer needs, and the demand for insurance protection and investment products. Industry changes caused regulatory institutions to evolve, and state supervisory evolution, in turn, has contributed to the development of the insurance industry. This has resulted in a nimble regulatory environment that clearly has served insurance consumers well.

Insurance Regulatory Modernization: A Dynamic Process

Insurance supervision in recent years has been subject to increasing external and internal forces, to which the states have responded. Fundamental changes in the structure and performance of the insurance industry have complicated the challenge. Competitive forces have caused insurers to assume increased risk in order to offer more attractively priced products to consumers. Insurance companies have become increasingly national and international in scope and have widened the boundaries of their operations. One constant, however, remains: Insurance markets and the perils consumers face remain uniquely local.

A singular U.S. market for property, auto and many other lines of insurance business does not exist. Each state, and in some cases, even each zip code, represents a distinct market, with varying risks, products and prices. Tort laws, court systems, workers' compensation laws and the perils for which individuals and businesses buy insurance differ widely from state to state. Unlike the federal government, states have acted quickly and decisively after recent natural disasters, ranging from the Gulf Coast hurricanes to wildfires in the West, and tailored their responses to the challenges of their particular states.

When state insurance markets are compared to other national insurance markets around the globe, the size and scope of those states' markets—and therefore the responsibility of state regulators—typically dwarfs the markets of whole nations (see attachment 3). Four of the top ten and twenty-six of the top fifty insurance markets in the world are U.S. states. For example, Mr. Chairman, the insurance market in your home state of Pennsylvania is larger than the insurance market in China. Likewise, the markets in Ohio and Michigan are larger than the markets in India, Ireland or South Africa. The market in Tennessee is larger than the market in Russia or Denmark. Each of these markets demands a local, accountable, and responsive regulator.

The insurance industry today is driven by individuals and families dealing with a local insurance agent to provide coverage for homes and autos, health care from local providers, whole and term life insurance products to protect young families against the economic devastation caused by the premature death of a breadwinner, and annuities and other investments to help fund a college education or retirement.

The convergence of forces has had a dramatic effect on the supervision of insurance. Over the past two decades, the states have engaged in an unprecedented program to revamp the framework of insurance oversight. Insurance officials have worked continuously to upgrade the state system to provide multi-state platforms and uniform applications to leverage technology and enhance operational efficiencies. A good share of this effort in the late 1980s and 1990s was directed at strengthening financial oversight by establishing higher capital standards for insurers, expanding financial reporting, improving monitoring tools and accrediting insurance departments. Subsequent initiatives have focused on improving the effectiveness and efficiency of product regulation, market surveillance, producer licensing, company licensing and general consumer protections.

The states have enhanced the resources devoted to insurance supervision, and the NAIC through its members has played a central role in state efforts to strengthen and streamline oversight of the insurance industry. These are not one-time silver bullet solutions, but rather represent a dynamic, ongoing process that changes and evolves along with the business of insurance that we oversee. The modern system of insurance supervision builds on over 150 years as stewards of a healthy, vibrant insurance marketplace founded upon a bedrock of comprehensive policyholder and consumer protection. But it also demands that state insurance officials be ever vigilant and nimble to anticipate and respond to the changing needs of consumers, the industry and the modern marketplace.

Modernize, Don't Federalize

As states have moved forward to modernize insurance supervision, Congress has begun to consider federal legislation related to insurance regulation. The NAIC and its members welcome Congressional interest in insurance supervision. At the same time, we urge careful analysis of any proposal to achieve modernization of insurance supervision through federal legislation. Even well intended and seemingly benign federal legislation can have a substantial adverse impact on existing state protections for insurance 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. Federal laws that appear simple on their face can have devastating consequences by limiting the ability of state insurance departments to protect the public.

Proponents of efforts to federalize the regulation of insurance use buzz words such as "uniformity," "modernization" and "streamlining"—all of which have been at the heart of the NAIC's successful efforts to strengthen the state regulatory process. Another familiar theme for the pro-federalization crowd is "deregulation," a concept that may sound appealing at first blush but in reality is fraught with peril. For what they are really talking about is *deregulating consumer protections*. Mr. Chairman, Congresswoman Pryce, Members of the Subcommittee, I would dare say that not one of your constituents would favor that—unless, that is, they are affiliated with an insurance company.

There are limited areas where insurance regulation could benefit from a federal presence. Note that I say *presence*, not *takeover* or *preemption*.

State insurance regulators have long been hampered by their inability to gain access to FBI background checks that may exist for potential insurance agents or brokers. We are committed to keeping the "rascals and scoundrels" out of our business, but we should have the same tools as other financial regulators in order to do our jobs as effectively as possible.

Certain catastrophes can be national in scope, overwhelming the ability of states and the private markets to handle them. The terrorist attacks on September eleventh are a good example, and indeed spawned the TRIA legislation that provides a federal insurance backstop in the event of a terrorist attack. A mega-natural disaster could well have the same effect—say, a large hurricane striking the Hudson River Valley or Long Island, or a major earthquake occurring along the New Madrid fault.

The federal government does not have a stellar record when it takes wholesale control of sectors of the insurance industry. Federal preemption of state regulation in the Medicare Advantage market in 2003 has caused numerous problems for consumers. Senior citizens have been victimized by abusive practices, including misrepresentation, deceptive or inappropriate sales practices, and in many instances, fraud. In Georgia, special agents for the state's insurance commissioner found that insurance agents had signed up *deceased* individuals prior to the enrollment period using the deceased individual's personal information retrieved from insurance agency databases and Medicare Part D applications. North Carolina insurance investigations revealed cases of insurance agents who had switched residents of an assisted living community from traditional Medicare into private plans without their permission.

In the absence of the federal preemption imposed by the Medicare Prescription Drug Improvement Act, many of these abusive practices would be prohibited by state law, monitored and questioned by watchful state regulators and controlled by the state regulatory structure. However, since these cases involve Medicare Advantage, or Part D, plans, the hands of state regulators are largely tied. The marketing guidelines are established by the federal government, states are largely prohibited from monitoring the marketplace and states have very limited ability to take corrective action against a company for misconduct. It has unfortunately become evident to states, lawmakers and consumer advocates that the federal government does not have the expertise nor the manpower to adequately protect consumers in this area.

In sharp contrast, Medicare Supplement (Medigap) insurance, which is monitored by effective state regulation, sees relatively few consumer complaints and no such widespread problems, even though it serves a similar population and is sold to seniors in a similar manner. In fact, several Congressional Committees are now looking to the state regulation of Medicare Supplement insurance as a potential template for remedying the problems with Medicare Advantage and part D plans.

Conclusion

The system of state insurance supervision in the United States has worked well and has continuously evolved for over 150 years. State regulators understand that protecting America's insurance consumers is our first responsibility. We also understand that commercial insurance markets have changed, and that modernization of state insurance standards and procedures is needed to facilitate more streamlined, harmonized and efficient regulatory compliance for insurers and producers.

The NAIC and its members—representing the citizens, taxpayers, and governments of all fifty states, the District of Columbia and U.S. territories—will continue to share our expertise with Congress on insurance issues having a national impact and welcome Congressional interest in our modernization efforts. We respectfully request Congress and insurance industry participants to work with us to continue to modernize insurance regulation and protect consumers. As our tremendous progress to date shows, that is the only practical, workable way to maintain the strong protections consumers demand—and deserve.

Insurance consumers require a financially sound and secure insurance marketplace that offers a variety of products and services. They have that now through an effective and responsive state regulatory system. Putting our record of success up against the uncertainties engendered by changing to a federal system is a losing bet. A nimble state-based system that works well at no cost to the federal government is far preferable to a one-size-fits-all federal regulatory scheme. When you look at the tradeoffs, we believe that you in the Congress will agree that insurance regulation is best left to home state officials with the expertise, resources, and experience to protect consumers in the communities where they live. Thank you for this opportunity to address you, and I look forward to your questions.

ATTACHMENT 1

State Insurance Departments' Continuous Improvement to the Solvency Framework

The state insurance department's solvency framework provides crucial safeguards for the United State's insurance consumers. This solvency framework includes all aspects of a potential insurer life cycle, including licensing, monitoring (i.e. financial reporting, financial analysis and examination), supervision/receivership and guaranty fund aspects. In order to ensure the effectiveness of the solvency framework, the state insurance departments over the past fifteen years have continually enhanced statutory authority and regulatory practices, including participation in the NAIC Financial Regulation Standards and Accreditation Program, which establishes baseline requirements in each state.

Notable enhancements by the state insurance departments over the last few years are as follows:

- Codification of accounting practices into one comprehensive manual, resulting in consistent and comparable financial statements;

- Enhanced financial reporting requirements on an annual and quarterly basis of key areas, including reinsurance, investments, reserves, significant disclosures, off-balance sheet risks, etc.;

    - The quality of insurer financial statements continues to benefit from the codification of statutory accounting principles and the state regulatory system of refining and improving instructions for statutory financial statements. While the number of companies filing with the NAIC have increased from 5,019 in 2004 to 5,083 in 2006, and the number of data quality consistency validations applied to each filing have increased as well, the number of errors generated from these validations have decreased from 12,111 in 2004 to 9,856 in 2006.

- Refinement and new development of the collection of regulator only analytical tools designed to provide state insurance departments with an integrated approach to screening, prioritizing and analyzing the financial condition of insurers operating in their respective states;

    - The significant use and refinement of analytical tools has steadily increased over the years from approximately 193,000 hits during 2001 to over 252,000 hits during 2006. The significant number of hits to these analytical tools demonstrates the number of useful tools available to regulators to analyze insurers in the most efficient manner. The increase in utilization demonstrates regulators constant attempt to improve their process through the development and use of additional tools.

- Strengthening existing statutory authority, such as risk-based capital requirements, examination authority, investment regulations, reserving statutes, actuarial opinion guidelines, receivership and guaranty fund schemes and frameworks, holding company considerations, including provisions regarding acquisition of control or merger;

    - As noted, these changes have strengthened statutory authority, and have helped regulators in their overall protection of insurance consumers. Some of these changes have been easily noticed, such as the increase in the level of capitalization in the HMO industry. In 1998, HMOs were required to complete the NAIC RBC formula for the first time, and the number of companies triggering an RBC action level has been reduced by 71% from 1998 to 2006, to only 34 companies. The life and property/casualty industry has generally been well capitalized, and the number of companies within an RBC action level for those industries has remained small at under 3% from 1994-2006.

- Enhanced financial examination and analysis procedures outlined in state insurance regulator handbooks and guidelines to be more risk focused in order to better target resources and regulatory efforts;

    - Early state adopters of the enhanced financial examination approach have developed a closer regulatory relationship with their domestic insurers, and in one case witnessed a dramatic reduction in examination costs; and

- Established a more efficient company licensing process through the development and implementation of the Uniform Certificate of Authority Application (UCAA) and an electronic tool for creating and submitting the applications.

    - Refinements in the UCAA processes and establishing best practices for regulatory reviews have reduced the average response time for UCAA applications from 174 days in 2005 to 55 days in 2007.

Ultimately, these accomplishments have allowed regulators to more easily identify troubled insurers and react in a manner that is in the best interest of policyholders and consumers.

- This fact can be illustrated by the decrease in the amount of correspondence that key regulators of multi-state companies have had to initiate with domiciliary states of troubled companies. More specifically, during the period 1992-1996, this type of communication with domiciliary states was necessary for 35% of potentially troubled companies. The following five years (1997-2001) this percentage decreased to approximately 30%, and the following five years (2002-2006), the percentage has decreased further to approximately 24%.

While some of this has to be attributed to the market cycle, it is also indicative of improved solvency regulation. Additionally, evidence exists to illustrate that the number of insolvencies has reduced over the last 10 years.

- This fact has been illustrated by information produced for public display by AM Best Rating agency. In March 2007, AM Best issued reports that showed how insurance impairments (which the report indicates is broader than insolvencies), have decreased from a five year high of approximately 97 per year through the years 1987-1991, to approximately 53 per year through the years 1992-1996, or approximately a 45% decrease. The same low level of impairments continued from 1997-2001, but has decreased even further during 2002-2006, where impairments are down 26% to approximately 39 per year. This public information is consistent with NAIC data, and in particular, the last five years indicates that insolvencies have decreased to 22 in 2001, and have steadily decreased to only 6 in 2006.

ATTACHMENT 2

State and NAIC Actions Regarding Producer Compensation Issues

In October 2004, the State of New York brought antitrust charges against a large insurance brokerage, stemming from contractual and implied arrangements between insurers and producers in which the insurer pays extra commissions to the producer based on a number of factors, such as the loss ratio or retention of business placed through the brokerage firm. These commissions were in addition to the regular, or "base," sales commission, and were often based on the performance of the insurer's entire book of business with an individual producer. Although these types of contingent commissions have been commonplace for more than a century, certain producers and carriers "rigged" the competition. For example, a producer would steer a particular piece of business to one insurer based on a favorable commission structure. In some cases other insurers participated by offering less-attractive prices, called "B quotes," to steer a policyholder to the pre-selected insurer. Producers also froze out insurers with less favorable commission arrangements, regardless of whether the insurers fit a customer's needs. In no uncertain terms, for both law enforcement and insurance regulation, this conduct constituted fraud, an unfair business practice, and a violation of state antitrust law.

When the original allegations surfaced in October 2004, the NAIC also appointed a task force to quickly develop a three-pronged national plan to coordinate multi-state action on broker compensation issues. The first prong of the NAIC's national action plan was to amend its existing Producer Licensing Model Act to require greater transparency of producer compensation in certain circumstances. The NAIC followed an accelerated time frame, adopting the amendment in December 2004 in order to have it available for 2005 state legislative sessions. The NAIC model disclosure amendment focuses on consumer protection. The amendment does not prohibit payment of contingent commissions or restrict the ability of producers to receive appropriate compensation for provided services. Instead, insurance agents and brokers are required to disclose the existence and certain terms of compensation arrangements, which in turn allows consumers to make informed choices. This approach respects business realities and market-driven forces, while at the same time prioritizing consumer protection. To date, seven states have adopted all or part of the reforms in the NAIC amendment, and others are considering them. Four more states have issued bulletins. These measures are in addition to existing statutory limitations or related disclosure regulations already on the books in many states. For example, one state barred contingent commissions in the mid-1980s. Also, by virtue of numerous settlements with brokers and carriers, written disclosure is becoming an effective industry standard.

The second prong of the NAIC's national action plan was to facilitate consistent regulatory action among the states, starting with the distribution of uniform templates for states to use in investigating producer compensation issues. Based upon the findings and monetary relief produced by the New York Insurance Department's settlement with Marsh & McLennan, the nation's largest producer, the NAIC's Broker Activities Task Force coordinated a multi-state regulatory settlement that has been joined by at least 32 other insurance departments. In exchange for releasing related regulatory claims, the signatory regulators can enforce the settlement's terms locally and receive compliance reports directly from Marsh & McLennan, while maintaining state-based ability to continue ongoing investigations. The Task Force released a similar settlement with the nation's second largest broker, Aon Corporation, which has garnered 28 signatory states. The Task Force is currently working on similar multi-state agreements with other large national producers. In addition, regulatory staff from six states, together with attorneys general from ten states reached a settlement with insurer Zurich North America arising out of bid-rigging allegations and resulting in $151 million in restitution to Zurich policyholders. The Zurich regulatory settlement has been adopted by fifteen chief insurance regulators to date. The Task Force has now wrapped up its work but the NAIC and its members will continue with collaborative efforts to reach settlement agreements with other producers and commercial insurance carriers, where appropriate and in conjunction with domestic regulators.

The third prong of this action plan is the development of the Online Fraud Reporting Mechanism discussed at page 8 of our testimony.

Attachment 3

Premium Volume -- Worldwide

Rank	Jurisdiction	Premium Volume (In Millions US $	Market Share	Rank	Jurisdiction	Premium Volume (In Millions US $	Market Share
1	Japan	$460,261	11.48%	26	Massachusetts	$39,668	0.99%
2	United Kingdom	$418,366	10 43%	27	Belgium	$37,889	0.94%
3	France	$251,164	6 26%	28	Georgia (USA)	$36,065	0.90%
4	Germany	$204,544	5.10%	29	Virginia	$35,548	0.89%
5	Italy	$138,679	3.46%	30	North Carolina	$35,127	0 88%
6	California	$131,366	3 28%	31	Maryland	$31,041	0.77%
7	New York	$127,596	3.18%	32	Connecticut	$30,860	0.77%
8	Florida	$101,704	2.54%	33	Brazil	$30,390	0.76%
9	South Korea	$101,179	2.52%	34	Sweden	$29,182	0.73%
10	Texas	$91,015	2.27%	35	Washington	$28,975	0.72%
11	Canada	$88,200	2 20%	36	Minnesota	$28,544	0.71%
12	Pennsylvania	$75,441	1.88%	37	Wisconsin	$28,402	0.71%
13	PR China	$70,805	1.77%	38	Missouri	$27,270	0.68%
14	Spain	$65,813	1.64%	39	Indiana	$26,233	0 65%
15	Netherlands	$62,669	1.56%	40	Colorado	$25,441	0 63%
16	New Jersey	$62,201	1.55%	41	Arizona	$25,350	0.63%
17	Illinois	$59,417	1.48%	42	Delaware	$24,779	0.62%
18	Australia	$52,561	1.31%	43	Tennessee	$24,345	0.61%
19	Taiwan	$51,562	1.29%	44	Denmark	$23,262	0 58%
20	Michigan	$50,027	1.25%	45	Russia	$21,504	0.54%
21	Ohio	$49,627	1.24%	46	Hong Kong	$19,842	0 49%
22	Ireland	$47,281	1.18%	47	Louisiana	$19,695	0.49%
23	India	$43,032	1.07%	48	Austria	$19,568	0.49%
24	Switzerland	$41,758	1.04%	49	Finland	$19,308	0.48%
25	South Africa	$40,731	1.02%	50	Oregon	$17,983	0.45%
	All the Rest	$436,338	10.88%				
	Worldwide Total	$4,009,608	100 00%				

Sources: NAIC Financial Database for USA and SwissRe Sigma No. 4/2007 for the remainder.

NAMIC®

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

STATEMENT OF JOHN BYKOWSKI

PRESIDENT AND CHIEF EXECUTIVE OFFICER

SECURA INSURANCE COMPANIES
APPLETON, WISCONSIN

ON BEHALF OF THE

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

AT THE HEARING ON

THE NEED FOR INSURANCE REGULATORY REFORM

BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES
OF THE
HOUSE FINANCIAL SERVICES COMMITTEE

OCTOBER 3, 2007

Good afternoon Chairman Kanjorski, Ranking Member Pryce and Members of the Subcommittee. My name is John Bykowski, and I am testifying today on behalf of the National Association of Mutual Insurance Companies. Founded in 1895, NAMIC is the nation's largest property and casualty insurance company trade association, with more than 1,400 members underwriting more than 40 percent of the property-casualty insurance premium written in the United States.

I am the President and Chief Executive Officer of Secura Insurance Companies located in Appleton, Wisconsin. Our company began in 1900 as a farm company, and has grown steadily so that today, we write about $330 million in personal, commercial and farm products through 400 independent agencies in 13 states. I also currently serve as Chairman of NAMIC.

We appreciate the opportunity to testify before you today on the need for insurance regulatory reform. NAMIC supports a *reformed* system of state regulation. While we agree with some of the criticisms you will hear today, ultimately, NAMIC believes reform at the state level is more likely to produce better results than further federal involvement in insurance regulation.

Let me explain why NAMIC and a majority of property-casualty companies take this position.

NAMIC and the Role of Mutual Insurers

Most NAMIC members are mutual insurers that are controlled by and operated for the benefit of their policyholders. The first successful insurance company in America was formed in 1752 by Benjamin Franklin and some of his Philadelphia neighbors to help insure their properties against fire loss. The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire is still in business today and is a NAMIC member.

In those early days, most insurance companies followed the Contributionship model of neighbors forming entities to help each other avoid certain financial ruin if their properties were destroyed by fire. The other predominate type of insurance company is the stock company, which is owned by its shareholders.

Today, NAMIC members account for 47 percent of the homeowners market, 39 percent of the automobile market, 34 percent of the workers' compensation market, and 32 percent of the commercial property and liability market.

The History of Insurance Regulation

States regulated the property-casualty insurance business until 1944, when the U.S. Supreme Court in the *South Eastern Underwriters* case declared that insurance was a form of interstate commerce and it could be regulated by the federal government. Instead of creating a federal insurance bureaucracy, the Congress responded the next year by enacting the McCarran-Ferguson Act which declared that "[T]he business of insurance, and every person engaged therein, shall be subject to the laws of the several States." The only exception would occur where the Congress enacted legislation that "specifically relates to the business of insurance." Since 1945, few exceptions have occurred with the result that insurance has been regulated at the state level.

NAMIC believes state regulation has generally served both consumers and insurers well over the years, particularly as it relates to the property-casualty business. Unlike the life insurance business, property-casualty insurance is primarily a state-based business. While some of our products cover interstate activities, most auto, farm, and homeowners policies are single state products. As such, we believe the states have the best understanding of our products and the people for whom our products provide protection.

Weaknesses of Current Regulation

NAMIC believes the state regulation must adapt to keep pace with today's global insurance market. Large and small insurers alike need to see changes in the state regulatory structure if they are to continue to provide customers with the products they need at the lowest possible prices.

The cornerstone of reform must be an end to price regulation for all property-casualty insurance lines. While several states have enacted reforms in recent years, more must be done. In every state that has enacted competitive based rating systems, the market has improved and consumers have more choices.

While some states allow pricing freedom for commercial insurance products, the fact remains that personal insurance lines are the only products in America with multiple sellers (there are approximately 2,700 licensed property-casualty companies) whose price is regulated by the government rather than by the marketplace.

This seems paradoxical to us when you consider that we trust people to make far greater decisions affecting their lives—such as their health plans and retirement investments—and yet government wants to control insurance prices. We understand the political sensitivity involved, but we would suggest that this is an historical anachronism at odds with the faith we place in individuals and the free marketplace in other parts of the American economy. I also would note that in Wisconsin, we had a total of 816 property-casualty companies operating in 2006, of which 183 were domiciled in the state.

A brief review of different state approaches to pricing may be instructive here. Since 1969, Illinois has had deregulated competition-based pricing for both personal and commercial lines. As a result, Illinois has experienced stable rates and few entrants in its residual market because it has attracted the largest share of private passenger auto and homeowner insurers in the nation. A few years ago, South Carolina and Louisiana adopted a flex-rating system for personal lines and the states have seen their auto prices fall and new insurers enter the market. In both instances, the markets improved as a result of adopting more market-based rating schemes.

At the other end of the spectrum, almost every state that has availability or affordability problems suffers from overregulation and price controls. Massachusetts, a strict prior approval state, now has only18 insurers selling private passenger auto insurance; Illinois has hundreds. Far too often, policymakers in these troubled jurisdictions react by placing a tighter regulatory grip on the market, which usually leads more insurers to leave the state, thus exacerbating availability and affordability problems.

While insurance price controls are the most troublesome feature of state insurance regulation, other examples also deserve attention. These include a lack of uniformity among states with respect to producer licensing laws, form filing procedures, underwriting restrictions preventing insurers from accurately assessing risk, expensive and otherwise unwanted coverage mandates, and arbitrary and redundant "market conduct examinations" that cost insurers enormous sums that could otherwise be used to pay claims

As a result of these and other problems, some large and international insurance companies believe a better option for them would be a federal regulator that would pre-empt the states' ability to regulate all insurers.

The Strengths of State-Based Regulation

Notwithstanding the need to improve state-based regulation, NAMIC believes the decentralized system of state-based insurance regulation has inherent virtues that would be lacking in a national insurance regulatory system. State insurance regulation has the capacity to adapt to local market conditions, to the benefit of consumers and companies, and affords states the opportunity to experiment and learn from each other.

A state insurance commissioner can develop expertise on issues particularly relevant to his or her state. Unlike banking or life insurance, property-casualty insurance is highly sensitive to local risk factors such as weather conditions, tort law, medical costs, and building codes. Many state building codes are fashioned to the risk found in that state. In the Midwest, these codes focus on damage from hail and tornados, while in coastal regions, the codes focus on preventing loss from hurricanes. In other states, seismic concerns dictate the building codes. Insurers must consider all of these factors in assessing risk and pricing insurance products. State insurance regulation can take account of these state and regional variations in ways the federal regulation cannot.

Insurance consumers directly benefit from a state regulators' familiarity with the unique circumstances of his or her state. Over time, state insurance departments accumulate a level of "institutional knowledge" that has helped regulators to develop consumer assistance programs tailored to local needs and concerns. Compared to a federal regulator, state regulators have a greater incentive to deal fairly and responsibly with consumers. Eleven state insurance departments are headed by commissioners who are directly elected by their states' voters; the others serve at the pleasure of governors who also must answer to voters. A federal regulator, by contrast, would be far less accountable to consumers in particular states, and would thus have less motivation to be responsive to their needs.

Is There a Need for Federal Regulation?

NAMIC believes the answer to this question lies in both an examination of how the states are responding to the problems outlined above and the likely outcome of federal legislation.

State Reforms

States have not been oblivious to the criticism that they need to change with the times, and they have made some significant progress in addressing antiquated rules such as those involving price controls and company licensing restrictions. On the matter of price regulation, specifically:

- Eleven states have adopted flex-band rating systems for property-casualty products to replace the rigid system of price controls.
- Fifteen states have adopted the more flexible use and file system.
- Twenty-six states have established no filing requirements, mostly for large commercial risks.
- Only 16 states still require statutory prior approval. Several of these states, however, are among the largest in the country, accounting for 40.8 percent of the total auto insurance market and 41.4 percent of the total homeowners insurance market nationwide.
- With respect to insurer licensing, the Uniform Certificate of Authority Application (UCAA) is now used in all insurance jurisdictions.
- A system of electronic filing has been implemented by most states and has streamlined the process by which rates and forms are filed by companies.
- Thirty states have now adopted the Life Insurance Interstate Compact, which allows the compact to now function and serve as a single point of filing for life insurance products.
- The National Conference of Insurance Legislators (NCOIL), the National Conference of State Legislatures (NCSL) and the American Legislative Exchange Council (ALEC) have all endorsed competition as the best regulator of rates. NCOIL has adopted a significant model law that would create a use and file system for personal lines and an informational filing system for commercial lines.

- NCOIL has also adopted a Market Conduct Model Law that will bring significant reform to that area of state regulation.

The Risks of Federal Regulation

One of the bills introduced in the 110th Congress would have the federal government assume a more active role in the regulation of the insurance industry. H.R. 3200, titled the "National Insurance Act of 2007," would establish an optional federal charter modeled on bank regulation. In essence, the bill would allow an insurer to choose between being regulated by the states or by a new federal regulatory system to be administered by an Office of National Insurance.

While the drafters of the OFC bill are proposing significant rate deregulation, which is our goal as well, the political and practical reality of the final product is much more likely to look like the burdensome California style regulatory system than it would an Illinois system.

NAMIC believes effective regulatory modernization can be accomplished without creating a new federal bureaucracy. While, an OFC seeks to:

- increase competition among multi-state insurers by streamlining and centralizing insurance regulation;

- exempt federally chartered insurers from notoriously inefficient and archaic rate regulation, which serves mainly to force low-risk policyholders to subsidize high-risk policyholders; and

- promote regulatory competition between federal and state regulators, with each striving to create regulatory regimes that provide the greatest benefit to insurers and consumers alike.

The problem is that in practice, an OFC would achieve few or none of these results, and that the potential risks are too great. Here are our greatest concerns:

- Federal regulation has proven no better than state regulation in addressing market failures or protecting consumer interests and, unlike state regulatory failures, federal regulatory mistakes can have disastrous economy-wide consequences. The savings and loan debacle of the 1980s that ended up costing taxpayers over $100 billion is the biggest such disaster in recent memory. Similarly, federal regulation of the pension system has failed to prevent recent numerous high profile failures.

- Under H.R. 3200, there could be a negative charter competition between the Office of National Insurance and state regulators. NAMIC is concerned an OFC would create an un-level playing field, with only larger companies choosing to be federally regulated. Proponents argue that all players in the market would be free to choose the regulator that best meets their business model and consumer needs, including shifting seamlessly between state and federal regulation. In reality, transaction costs, as well as retraining and retooling costs, would be significant and could effectively lock smaller and medium sized insurers into their original choice of regulator and providing only an illusion of choice for many producers or insurers.

- Disastrous social regulation in exchange for the new regulatory structure (under H.R. 3200). Social regulation encompasses any number of measures that tend to socialize insurance costs by spreading risk indiscriminately among risk classes. Without risk-based underwriting, the insurance enterprise cannot operate. By weakening the link between expected loss costs and premiums, underwriting restrictions create cross-subsidies that flow from low-risk insured to high-risk insureds. While NAMIC favors price competition, we are not so naive as to believe that the same political dynamic that makes it so difficult to achieve price competition in the states will not recur during the debate on federal regulation. Just as political expediency occasionally leads state office-holders and candidates to call for insurance price controls and rate rollbacks, we can easily imagine situations in which their federal counterparts would be tempted to do the same. What we are likely to be left with, then, is no pricing freedom and more social regulation.

- Proponents of an optional federal charter argue that the legislation would simply create an alternative regulatory scheme for those who seek it. NAMIC believes that it could well result in dual regulation for insurers as it has for banks. A dual regulatory system would ultimately increase costs for insurers and policyholders and create the potential for regulatory confusion. In addition, insurers choosing to remain under state regulatory jurisdiction are likely to find themselves subject to a vast array of federal rules, but would not enjoy the benefits of uniformity. One must look only as far as the health insurance system to see the potential pitfalls of dual regulation. As you know, health insurance is regulated by both state and federal law. This is a regulatory scheme that we do not want to occur in the property-casualty industry. It also has created a situation in which consumers seeking assistance from regulators are often caught between state and federal agencies, depending on the problem at hand. The added costs of dual health insurance regulation are eventually passed on to consumers, as are all regulatory costs. Under an optional federal charter for property-casualty insurance, consumers will likely suffer the same confusion that exists under the health insurance regulatory structure.

Additionally, we believe a federal regulator would be less sensitive to both company and consumer concerns. Consumers and smaller companies like mine would not receive the same level of response they now receive from their state regulators. In 2006, the states combined processed 383,654 consumer complaints and handled an additional 2.5 million consumer inquiries. Is a Washington DC federal bureaucrat on a 1-800 number going to be as sensitive to consumer and company complaints as a local regulator? For small and regional companies like mine, I worry that my voice will be muted in DC, as we might have problems reaching the right federal regulator if we had an issue. Right now, in my home state of Wisconsin, I have on numerous occasions picked up the phone and called my insurance commissioner on regulatory issues that impacted my company and our policyholders. And the Wisconsin insurance commissioner can do the same with me. The Commissioner has visited my company on numerous occasions to discuss insurance regulatory matters. Do you think this would be possible under a federally regulated model?

Finally, I also would note that in contrast to other insurance products, the property/casualty business is highly dependent on state and regional differences. Insurance is subject to state and regional differences in legal systems and reparation laws: geographical differences impacting weather patterns and catastrophes; differences in demographics affecting population concentration, driving patterns, and land use; and state and local laws establishing driving rules, building codes, among numerous state differences. These differences are particularly critical for personal lines property and casualty coverage's (auto, homeowners, personal liability) making a "national" products and regulation difficult.

The McCarran Repeal Effort

While I recognize that the following bill does not come under the jurisdiction of the Financial Services Committee, I nevertheless wanted to inform you that NAMIC is deeply concerned about H.R. 1081, the Insurance Industry Competition Act of 2007, which, if enacted, would repeal the very limited antitrust exemption found in the McCarran-Ferguson Act.

Proponents of H.R. 1081 and its Senate counterpart, S. 618, have argued that repealing McCarran would improve property insurance availability, affordability and claims handling, especially in disaster-prone regions.

NAMIC believes that repealing McCarran would have the opposite effect. For insurers, repealing McCarran would mean that companies like mine would no longer be able to access credible loss cost data. This, in turn, would cause companies like mine to exit insurance markets due to increased costs of estimating losses, thereby leaving consumers with fewer choices and less competitive markets.

Earlier this year, NAMIC commissioned Dr. Lawrence S. Powell, the Whitbeck-Beyer chair of Insurance and Financial Services at the University of Arkansas-Little Rock, to examine McCarran and to see what the consequences would be if it were repealed. Powell's research, which is titled, "The Assault on the McCarran-Ferguson Act and the Politics of Insurance in the Post-Katrina Era," was made public two weeks ago.

His paper concludes that repealing McCarran is not good public policy because: insurance markets are competitive; the limited antitrust exemption does not harm consumers; repealing McCarran would ultimately harm consumers; and the best way to provide for affordability and availability of insurance products was through state regulatory reforms.

If Not OFC, or McCarran Repeal, What Can Be Done?

As I indicated earlier, the "shotgun" approach to insurance regulatory reform embodied in the optional federal charter proposal would bring uncertain benefits while potentially creating a variety of negative consequences. The same would be true for repealing McCarran.

I have also indicated that government rate regulation and restrictions on underwriting freedom pose the greatest impediments to the creation of healthy, competitive property-casualty insurance markets.

While NAMIC strongly opposes an OFC, we do believe that Congress could potentially play a limited role in achieving some targeted reforms that the states have not yet acted on, such as a "targeted federal tools" approach. And, indeed, the House already has taken a positive step in that regard by passing H.R. 1065, which streamlines regulation for nonadmitted insurance and reinsurance carriers. If this is an approach that Congress wishes to follow, here are two issues that members may wish to consider:

1. Prohibit states from limiting property-casualty insurers' ability to set prices for insurance products, except where the insurance commissioner can provide credible evidence that a rate would be inadequate to protect against insolvency; and,
2. Prohibit states from limiting or restricting the use of underwriting variables and techniques, except where the insurance commissioner can provide credible evidence that a challenged variable or technique bears no relationship to the risk of future loss.

Conclusion

In conclusion, NAMIC believes that not enough states have acted as rapidly or as thoroughly in creating insurance regulatory reforms, but states have picked up the pace in recent years and appear headed in the right direction. States need more time and perhaps a federal prod along the lines of a federal tools approach. In no case, however, should Congressional action take the form of creating an optional federal charter or repealing McCarran.

Given this recent progress and the risks associated with creating an entirely new federal regulatory structure, NAMIC is convinced that reform at the state level is the best and most appropriate course for consumers and insurers alike.

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News Release

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State – Not Federal - Regulation Works Best for Property/Casualty Insurance Consumers, NAMIC Tells Congress

WASHINGTON (Oct. 3, 2007) - Property/casualty insurance consumers would be best served by reforming the current state-based regulatory system rather than a new federal bureaucracy, according to the National Association of Mutual Insurance Companies (NAMIC). In testimony before a congressional subcommittee hearing today, NAMIC Board Chairman John A. Bykowski, president and CEO of Appleton, Wis.-based SECURA Insurance, said it would be a mistake to impose further federal authority over the property/casualty insurance industry.

The House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held the hearing, The Need for Insurance Regulatory Reform, to examine criticism of the current regulatory system.

"Unlike banking and life insurance, property/casualty insurance is subject to local risk factors, such as weather conditions, tort law, medical costs, and building codes," Bykowski testified. "State insurance regulation is able to take account of these differences in ways that federal regulation would not."

Bykowski agreed with the need to reform the state-based regulatory system. "Many states have made progress in recent years toward adopting needed reforms," he said. "They have softened company licensing restrictions, for example, and, in some cases, they have moved away from strict rate regulation."

Federal regulation could take any number of forms. One proposal before Congress, H.R. 3200, would impose an optional federal charter to ostensibly allow insurance companies to choose to be regulated by either the state or federal government.

"NAMIC believes the choice offered by H.R. 3200 will prove to be illusory," Bykowski testified. "The cost to a company of adopting a federal charter is likely to be quite high, and switching back to a state charter could be even more expensive," leaving thousands of small- to medium-sized insurers trapped in whatever system they initially choose because changing to the other system would be cost prohibitive.

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The negative outcomes of an optional federal charter would far outweigh any potential benefits and would likely hurt consumers and markets, Bykowski told the panel. "It's clear that federal regulation has proven no better than state regulation at addressing market failures or protecting consumer interests," he said. "Moreover, unlike state regulatory failures, federal regulatory mistakes could have disastrous economy-wide consequences. The savings and loan debacle is an example of what can happen."

"NAMIC believes that while the states have not acted as rapidly or as thoroughly to modernize insurance regulation as necessary, we are encouraged that they have picked up the pace of reform and are headed in the right direction," Bykowski told the subcommittee. "Given this recent progress and the risks associated with creating an entirely new federal regulatory structure, NAMIC is convinced that reform at the state level is the best and safest course for consumers and insurers alike."

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STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES OF THE COMMITTEE ON FINANCIAL SERVICES OF THE UNITED STATES HOUSE OF REPRESENTATIVES

ON

THE NEED FOR INSURANCE REGULATORY REFORM

October 3, 2007

Statement Made by

Christopher M. Condron
Chairman of the Board & Chief Executive Officer
AXA Equitable

Mr. Chairman and members of the Subcommittee, my name is Christopher Condron. I am CEO of AXA Financial, Inc. and Chairman and CEO of its principal insurance operating subsidiary, AXA Equitable Life Insurance Company. AXA Equitable was formed in 1859 as The Equitable Life Assurance Society of the United States. We became a member of the global AXA Group 15 years ago. With operations in nearly 50 countries around the world, the AXA Group is one of the world's largest diversified insurance companies.

I am appearing today on behalf of the American Council of Life Insurers, the principal trade association for U.S. life insurance companies. The ACLI's 373 member companies account for approximately 93% of the industry's total assets, 91% of the industry's domestic life insurance premiums and 95% of its domestic annuity considerations.

I appreciate the opportunity to appear before you today to discuss the critical need to substantially overhaul and modernize the insurance regulatory system in the United States. Indeed, I firmly believe that for the life insurance business to remain viable and serve the needs of the American public effectively, our system of regulation must become far more efficient and responsive to the needs and circumstances of a 21st century global business.

I think I bring a distinctive perspective to this issue. Prior to joining AXA Equitable in 2001, I was President and Chief Operating Officer of Mellon Bank Corp. (now Bank of New York/Mellon) and CEO of The Dreyfus Corporation, BNY/Mellon's mutual fund subsidiary. National banks like BNY/Mellon, and mutual fund companies like Dreyfus, are principally regulated at the federal level. The same holds true for most broker dealers.

That experience leaves me unsurprised that among the most vocal supporters of insurance regulatory modernization are many financial institutions that already enjoy the benefits of federal regulation. For example, achieving insurance regulatory modernization through the enactment of optional federal charter legislation is a key priority of the Financial Services Roundtable of which I am Vice Chairman – an organization a majority of whose membership is comprised of federally chartered banks and national and regional securities firms. Many of these institutions, of course, are keenly interested because they are also in the insurance business. For example, a large percentage of banks and securities brokerage firms distribute insurance products – and labor under the inefficiencies of disparate and complex state-specific rules relating to agent licensing. Those rules, which impose different qualification, registration and continuing education requirements for each state in which an agent seeks to do business, make it difficult to serve an increasing mobile society. As someone who started his career as a salesman in the retail financial services business, I can relate to the challenge of having to endure new licensing and continuing education burdens simply because a long-time client moves to a state in which the agent is not already licensed – which is also the key reason why so many producers favor a federal regulatory option.

I would suggest, however, that the real reason why so many federally regulated financial institutions support insurance regulatory reform has relatively little to do with corporate self-interest. I believe that most financial services CEOs these days see the far bigger *national* interest in addressing the outmoded state-based insurance regulatory system. For them, I would submit that this is not a competitive issue at all. Instead, I believe that they recognize far better than most the criticality of assuring that we have an efficient and effective life insurance industry in the United States.

The Essence of That National Interest – Encouraging Innovation

One of the most significant benefits of insurance regulatory reform will be the elimination of substantial barriers to innovation – particularly as they relate to the ability of the insurance industry to leverage its unique franchise to help address the looming retirement security crisis as some 77 million baby boomers near retirement.

Changing demographics and other related factors have given rise to a true retirement security crisis in this country. Medical advances continue to extend life expectancies and lengthen time spent in retirement. Medical costs are increasing, particularly for retirees, while retiree health coverage continues to decline. Employers are discontinuing defined benefit pension plans, and employees covered by these plans are leaving earlier with lower benefits. Rising retirement age thresholds and lower rates of benefit increases mean Social Security will replace a significantly lower percentage of pre-retirement income for future retirees. Lower interest rates mean fixed income returns are lower. Taken together, these factors lead to the inescapable conclusion – borne out by numerous studies – that one of the biggest challenges people will face in retirement is outliving their assets.

Life insurers provide an array of products and services that benefit Americans in all stages of life, including life insurance, annuities and other retirement savings plans, disability income insurance and long term care insurance. Currently, there are over 375 million life insurance policies in force, providing Americans with over $19 trillion in financial protection. In addition, Americans have saved $1.7 trillion towards their retirement by investing through our annuity products.

We are in a unique position to help America deal with the retirement security crisis. Significantly, life insurers – and only life insurers – can convert retirement savings into a guaranteed lifetime stream of income. That capability may well be the most potent tool that the private sector possesses to address the retirement savings challenges this nation faces.

Over the last decade, insurers have developed new and creative ways to leverage this capability to help Americans save for retirement and create sustainable, secure income streams during retirement. I am proud that AXA Equitable was a pioneer in that effort. Ten years ago, we transformed the basic variable annuity – a product in which investors took 100% of the risk of loss on their investments – by adding a guarantee feature that substantially shifted much of the risk of investing in equities from our customers to us.

Not only does this product encourage investors to pursue a more growth-oriented investment strategy to and through retirement, it gives them the confidence to stay the course during market downturns – thus significantly reducing the destructive "buy high, sell low" behavior to which too many investors succumb. In so doing, it offers them the potential to earn the higher long-term investment results that, history teaches, equity markets have delivered in most cases.

Ours was a true "category changing" innovation. Since we introduced this breakthrough design – the first of what have come to be known as "guaranteed living benefits" – others have offered their own versions and variations. Collectively, products with these features currently account for the large majority of variable annuity sales, which are projected to approximate $175 billion in 2007.

In order to get this product to market, however, we had to confront and overcome a regulatory system that was – and continues to be – resistant to innovation. Indeed, we are working on even more ambitious ideas – ideas that have the potential to have a far greater impact on the retirement savings challenges we face. However, our experience to date suggests that they will not find support from our state regulators.

If you take nothing else from my testimony today, please let it be this: the most important thing that you can do to stimulate further breakthrough innovation from the life insurance industry is to address the regulatory barriers that so frustrate innovation.

How the Current Regulatory System Frustrates Innovation

To encourage innovation, it is neither necessary nor desirable for a regulatory system to have lax standards. Indeed, we do not think the insurance industry would be advantaged by a weak regulatory system. We do submit, however, that to encourage innovation it is important for there to be uniform standards, consistently applied and efficiently administered, with a minimum of duplication or redundancy. The current state regulatory system meets none of these criteria.

Life insurers today operate under a patchwork system of state laws and regulations that lack uniformity and are applied and interpreted differently from state to state. The result is a system in which insurers must navigate a multiplicity of different regulatory gauntlets in parallel, each subject to its own timetable, in order to bring a product to market nationally. While they say that little is certain in life, for insurers this much is certain: there is no such thing as a single product for a national market and getting products approved on a national basis is extremely time consuming. The reality of the state regulatory system is that, inevitably, insurers will wind-up with multiple variations of any product they try to bring to a multi-state market, due to differing state-mandated changes. Moreover, in contrast to the more centralized, streamlined regulatory systems of the banking and securities businesses that allow them to get products to the national marketplace quickly – often within 30 to 90 days – it can take up to two years or more for life insurers to bring a product to market nationwide.

And the product approval process is not the only impediment to innovation. Virtually every aspect of our business is subject to disparate laws, disparate regulations and disparate interpretations of these laws and regulations that stifle innovation. Concerns in this regard include, among other things,

- the capital and reserving standards we must meet,
- the rules by which we administer our products,
- our sales practices
- and the qualifications and licensing standards for people who sell our products

The result fractionalizes what, for so many companies, is a national business – depriving insurers of the scale and speed to market that are so necessary to sustaining innovation. As but one example, the intractability of regulators in some states and the bureaucracy in others means that there are states in which AXA Equitable is still selling a product that is three generations older than what we are selling in most of the rest of the country.

Not surprisingly, the large number of product variations creates significant challenges for our operations and customer service areas that must manage and administer these multiple versions over the life of the contract – which in our business often means the *lifetime of the customer*. It also creates enormous headaches and inefficiencies for the more than 600 distribution companies and the more than 90,000 individuals have been appointed by us to sell our products. That's one reason why so many producers have come out in favor of reforming insurance regulation. Thousands of them have joined a grassroots organization – Agents for Change – whose mission is to give voice to their frustrations with the current system. The National Association of Independent Life Brokerage Agencies ("NAILBA") has endorsed the concept of federal regulation and the Association of Advanced Life Underwriters ("AALU") supports the concept of optional federal charter legislation which provides life insurance producers and carriers with the ability to choose federal or state licensing and regulation. Among the most significant benefits that producers will realize in a federal regulatory system is the opportunity to get a single national license, with a singular qualification, renewal and continuing education requirements.

While most aspects of insurance regulation are state specific, state boundaries do not constrain <u>all</u> aspects of state regulation. Paradoxically, in some cases, state regulation vests extraordinary extraterritorial reach in an insurer's home state regulator. For example, a home state regulator can determine capital requirements for business done nationwide. This, of course, creates the potential for radically disparate protections of consumers *within the same state* – and since capital is typically among an insurer's biggest costs, *radically different costs of doing business* for insurers depending on their state of domicile.

It goes without saying that, in addition to frustrating innovation, the burdens and costs of state regulation leave the insurance industry at a serious competitive disadvantage relative to other segments of the financial industry. Far more than ever before, life insurers find themselves in direct competition with brokerages, mutual funds, and commercial banks, particularly as providers of investment and retirement security products. Overwhelmingly, brokers, fund companies and banks benefit from much more efficient systems of regulation, often with a single, principal federal regulator. Without question, the regulatory efficiencies they enjoy translate into very real marketplace advantages.

Solutions

The ACLI carefully considered various ways to address the issue of regulatory reform, and focused in particular on four possibilities: improving the state-based system; regulating by the state of domicile; establishing federal (national) standards that would be administered by the states; and the creation of a federal charter option. Ultimately, the industry settled on a dual-track approach to regulatory reform under which we continue to work with the states to make a state-based regulatory system operate more efficiently and at the same time push for an optional federal charter. We believe the dual banking system provides an excellent template for a regulatory system that ensures company solvency and consumer protection, promotes efficiency and accommodates the operational needs of a diverse industry. The availability of a federal option would encourage state regulators to be more responsive and would establish a federal insurance regulator as a peer to other financial regulators in the critical Washington arena. For insurance companies doing business on a national basis, the ability to interact with one regulator rather than 51 would dramatically reduce what has increasingly become a logistical and administrative nightmare.

At the same time, we are working diligently with the states and the National Association of Insurance Commissioners to modernize state insurance regulation. Even with a federal chartering option, there will undoubtedly be a significant number of insurers that will wish to remain state regulated, albeit under a more modern and efficient system. Toward this end, the ACLI is actively engaged with, and fully supportive of, the NAIC's initiative to advance an interstate compact approach to provide for a uniform mechanism under which life insurance company product filings and approvals can take place. While the states deserve enormous credit for making the interstate compact a reality, as of today many of the most populous states are not participants, materially reducing its potential utility. And it is very important to keep in mind that as successful as the compact may ultimately prove to be, it addresses only one of the many aspects of state regulation that suffers from a lack of uniformity.

The Difficulty in Addressing Critical Issues Absent a Federal Charter Option

In just the last year, Congress has addressed a number of issues involving the life insurance business that have proved difficult to resolve absent a federal insurance regulator. Should a federal charter option become a reality, current issues like military sales, sales to seniors, data security, privacy, travel underwriting and the ability to combine annuities with long term care features would be much easier to solve on a national basis. Recent congressional discussion on each of these significant consumer issues has demonstrated the difficulty of imposing federal solutions on a state regulated business.

The combination of annuities and long term care is an excellent example of this problem. Just last year in landmark legislation passed by Congress, tax barriers were removed to help the life insurance industry make available a product that will be extremely beneficial to consumers. Yet due to the widely disparate laws that exist state to state, there continue to be significant obstacles to our ability to get such combination products to the people who need them.

Industry initiatives designed to benefit consumers have been similarly hindered by the difficulty of addressing issues on a national basis. The ACLI's member companies have recognized that the disclosure we provide potential purchasers of annuities could be significantly enhanced. The industry developed concise disclosure templates for annuities, field tested them with consumers with extremely favorable results, and then approached state regulators asking that they be embedded in state regulation and not merely accepted as a form of voluntary best practice. While state insurance regulators have viewed these templates favorably and agree with the need for enhanced annuity disclosure, we can only implement this beneficial disclosure by going to each state and working through their individual regulatory process. This will be a multi-year effort, and even then we may not be able to get all states to embrace this uniform approach to improved disclosure.

Consumer Benefits and Protections

Those resisting the advent of a federal chartering option assert that the optional federal charter would be fundamentally inconsistent with the best interests of consumers. When the facts are carefully considered, nothing could be further from the truth.

The life insurance industry advocates a federal charter option built around strong solvency and strong market conduct oversight, patterned after the best state statutes or model laws in existence today. This would necessarily include robust, uniform regulation in the areas of capital, reserves, nonforfeiture standards, accounting and investments, among other things. And consumers would enjoy a high level of protection under this system regardless of where they live, or where their insurer is domiciled or where a product is purchased. To be clear, anything less is not in the best interests of life insurance companies or their customers.

An optional federal charter would offer all customers access to the same products; uniform rules regarding sales and marketing practices of companies and agents; strict, frequent and consistent market conduct and financial examination of national insurers; and the opportunity to continue to work with a trusted insurance agent if the consumer moves from one state to another where today the agent may not be licensed.

Moreover, an optional federal charter holds the promise of significant cost savings. Two recent studies have quantified those savings. As noted in these studies, the life insurance market in the U.S. is mature and price competition is intense. In such circumstances, it is entirely reasonable to expect that a meaningful portion of those savings would be realized by consumers in the form of lower premiums.

The first study, conducted by Steven W. Pottier of the University of Georgia, focuses on potential cost savings to life insurers. It finds that life insurance costs could be reduced by an estimated $5.7 billion annually if insurance companies functioned under a single regulator system as opposed to the current system of multiple regulators.

The second study, by Laureen Regan of Temple University, focuses on the cost savings that could be realized by insurance producers (agents) under a federal charter option. The study estimates that the savings in producer licensing associated with moving to an optional federal charter from the current system of exclusive state regulation could range from $268 million to $377 million annually. In addition, an optional federal charter would benefit producers by creating uniform requirements for pre-licensing and continuing education.

Misperceptions Regarding an Optional Federal Charter

Regulatory Arbitrage - Some have suggested that the implementation of a federal charter option would lead to regulatory arbitrage as companies seek increasingly lax regulation and regulators rush to accommodate. However, we are highly confident that Congress would be careful to assure that any federal regulatory option was at least on a par with the strongest state systems. Indeed, the industry is seeking uniform regulation, not weak regulation. Moreover, the potential for regulatory arbitrage already exists in the current state-based system. Today, insurers have the right in virtually all jurisdictions to change their state of domicile – that is, to move to a different state that would have primary responsibility for the company's financial oversight. We fail to see how adding the option of a strong federal regulator would increase the potential that exists today. Finally, we submit that these dire predictions find no support in the experience of the dual charter bank regulatory system.

State Premium Tax Revenue - Opponents of an optional federal charter have suggested that if such an option were to become a reality, national insurers would, over time, somehow escape the payment of state premium taxes, which constitute a significant source of revenue for all states. This concern is unfounded. As this Subcommittee knows better than most, with the exception of Government Sponsored Enterprises, all for-profit federally chartered financial institutions such as commercial banks, savings banks and thrifts pay state income taxes. Insurers' state tax obligations predominantly take the form of a state premium tax. There is no precedent for, nor is there any expectation of, exclusion from this state tax obligation. Indeed, all versions of the optional federal charter legislation introduced to date expressly provide for the continuation of the states' authority to tax national insurers.

Cost – Skeptics of the optional federal charter have asserted that this initiative will result in some huge bureaucracy that will cost taxpayers untold millions. However, the life insurance industry has made clear from the outset that it is asking for a new federal regulator that would be funded exclusively through filing and user fees. Moreover, the industry has recommended that the initial costs of the regulator be covered through a loan that the industry would pay back over time. In sum, the industry and not taxpayers would pay for a new federal insurance regulator.

The Importance of the Life Insurance Industry from an Economic Standpoint

The need for comprehensive regulatory reform should also be considered from an economic standpoint, since the life insurance industry plays a key role in capital formation and is a significant component of the overall U.S. economy.

The long-term commitments and investments of the life insurance industry place it as one of the largest investors in the U.S. economy assisting in economic growth. In managing these obligations, the life insurance industry has invested $4.8 trillion in the financial markets, representing 9% of the capital supplied to the U.S. economy by the financial services industry, or 4% of the total capital in the **entire** U.S. economy. Life insurers are one of the largest holders of long-term, fixed rate commercial mortgages in the U.S. These long-term financial commitments are generally ten years and longer in maturity, much longer than commitments made by other financial intermediaries. In addition, our most recent figures indicate that life insurers invested $225 billion in new net funds in the nation's economy, an amount equal to about 30% of the net new funds saved by persons in the U.S. Fifty-seven percent of the industry's assets, or $2.7 trillion, are held in long-term bonds, mortgages, real estate, and other long-term investments. This includes: $523 billion invested in federal, state and local government bonds, helping to fund urban revitalization, public housing, hospitals, schools, airports, roads and bridges; $314 billion invested in mortgage loans on real estate financing for homes, family farms and offices; $1.8 trillion invested in long-term U.S. corporate bonds; and $1.5 billion invested in corporate stocks. The importance of the continued growth and vitality of the life insurance industry to Americans cannot be overstated.

International Considerations Strengthen the Case for Federal Regulation

The absence of a federal insurance regulator leaves the U.S. insurance industry at a distinct disadvantage in a variety of ways. For example, foreign markets offer additional growth opportunities. Life insurance premiums in the U.S. grew by only about 4% in 2006. In contrast, premium growth in India was 60% in 2006; in Africa, 22%; in Central and Eastern Europe, 19%; in Latin America, 14%; and in China life insurance premiums grew over 9% in 2006. Yet, when U.S. life insurers try to expand into these and other growing markets they are often rebuffed. The reason is that, from the European Union to China, other countries perceive that our current insurance regulatory structure discriminates against foreign companies and/or is so complex, inefficient, and costly as to be a de facto trade barrier.

There may be merit to these concerns. For example, over 20 states will not license insurance companies owned by foreign governments. Moreover, states have widely varying requirements about who can serve on a life insurer's board of directors, based on the nominee's residency, citizenship and other attributes – all of which can pose particular problems for foreign owners. Indeed the very terms the states use to describe a company based overseas, 'alien' (*i.e.,* subsidiaries or branches of non-U.S. insurers) versus 'foreign' (*i.e.,* subsidiaries or branches of another U.S. state insurers) are viewed as politically charged and discriminatory. And recently, the European Commission has expressed frustration that may force it "to explore other routes to ensure that EU reinsurers receive a fair treatment" in connection with states' requirements that even highly rated European insurers deposit liquid assets in the U.S. in an amount equal to their gross U.S. liabilities as a precondition to insuring U.S. life insurers.

In addition, the absence of a federal insurance supervisory authority operationally impedes the ability of U.S. life insurers to compete overseas. For example, neither U.S. state governments nor the NAIC have the constitutional authority to enter international agreements of mutual recognition or joint supervision on behalf of the U.S. Similarly, the U.S. has no national insurance supervisor with the legal mandate to represent the government or the interests of the industry in responding to crisis or maintaining stability. We are also unrepresented in the growing collaborative interactions of global financial services regulators generally covering broad economic, fiscal, regulatory, and trade matters – leaving us at a distinct competitive disadvantage.

Conclusion

Life insurers today operate under a patchwork system of state laws and regulations that is not uniform and that is applied and interpreted differently from state to state. The result is a system characterized by duplication, inconsistency, and inefficiency. While the most obvious effects of this system are the delays in getting products to market and the unnecessary expenses that result from redundancy and inconsistency, the most pernicious effect is that it frustrates innovation. As the only segment of the financial services industry that can guarantee income for life, insurers have a unique platform from which to help address the looming retirement security crisis facing this nation. Failure to reform insurance regulation prevents insurers from optimizing the value of their unique capabilities. Moreover, it leaves insurers in an increasingly untenable competitive position relative to other domestic and international financial services companies.

Mr. Chairman, for the benefit of our country, our customers and our industry we urge you to work with us on an expedited basis to put in place an appropriate federal regulatory option.

Statement of Albert R. Counselman, CPCU
on behalf of The Council of Insurance Agents & Brokers

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

"The Need for Insurance Regulatory Reform"

October 3, 2007

Good morning, Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee. My name is Albert Counselman. I am Chairman and CEO of Riggs, Counselman, Michaels and Downes (RCM&D) in Baltimore, MD and past Chairman of The Council of Insurance Agents & Brokers ("The Council"), on whose behalf I testify today. Thank you for this opportunity to speak with you today on the need for insurance regulatory reform.

The Council represents the nation's leading insurance agencies and brokerage firms, including RCM&D. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place more than 80 percent – well over $200 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked to secure innovative solutions and create new market opportunities for its members at home and abroad.

Riggs, Counselman, Michaels and Downes, the largest independent agency / brokerage firm in Maryland, has doubled in size in the last five years. We have a staff of nearly 300 people working from five offices – in Baltimore, Washington, Richmond, Virginia Beach and Harrisburg. With over $40 million in annual revenue and $400 million in annual premiums placed for our clients, we are one of the 65 largest commercial insurance agents and brokers in the United States, as reported by Business Insurance. Our clients range from large, multi-state employers in the Fortune 1000, to large and small hospitals, to mid-sized and small businesses and individuals. The firm provides risk management, including risk control and claim management programs, commercial and personal insurance, self-insurance and employee benefit programs. We work with most of the largest and most well known insurers operating in the U.S. and many located overseas.

RCM&D has been in business since 1885 and continues to be privately owned by individuals active in the operation of the business. Through our ownership and membership in organizations such as Assurex Global, we service clients locally as well as throughout the U.S. and the globe.

Introduction

Insurance regulatory reform, which is critical for the long-term health of our industry, is long overdue. Modernization of the insurance regulatory structure is an important element in maintaining a strong, vibrant insurance sector and is essential to allow the marketplace to evolve in order to address the needs of insurance policyholders in the 21st century. Unfortunately, the current regulatory structure for insurance is simply not equipped to handle an insurance marketplace that today is not just national but international in scope and also is both increasingly complex and sophisticated. My firm serves clients in 50 states and multiple countries – not unlike most of the other member firms of The Council, yet strikingly different from the local mode of operation that existed for many of us 20 – or even 10 – years ago. Like the marketplace, our clients have risks and exposures that transcend state boundaries and are both national and international in scope. The current state regulatory patchwork quilt of regulation not only has not kept up but cannot keep up due to the globalization of the business, and the current regulatory failures have had a very real and detrimental impact on the availability and affordability of coverage for commercial insurance consumers.

The Council is not opposed to regulation. Our members support prudent regulation that benefits consumers, but the current state structure does not get us that. This is why we are a strong supporter of insurance regulatory reform and are working so hard for change.

As a preliminary matter, we would like to thank the Subcommittee for its successful efforts in crafting the Non-admitted and Reinsurance Reform Act (H.R. 1065) and achieving unopposed adoption of the bill on the House floor. Title 1 of the bill would streamline the regulation of the surplus lines insurance marketplace, primarily dictating that the rules and regulations only of the insured's home state would apply to any multi-state surplus lines transaction. The NRRA is a critical piece of insurance regulatory reform legislation, the adoption of which will have an immediate positive impact on consumers and the insurance marketplace and, equally important, will complement the adoption of the broad-based regulatory reform envisioned by pending OFC legislation.

The Council also is very grateful to Representatives Bean and Royce for drafting and introducing The National Insurance Act of 2007, H.R. 3200. Representatives Bean and Royce and their staffs have assumed a major undertaking with a great number of issues and interests that will require careful consideration and deliberation, and we recognize it may take some time to reach the finish line. Having said that, the legislation provides an excellent framework to reach that goal and we endorse the bill wholeheartedly. The Council has been a strong advocate for regulatory reform – specifically a federal charter option – for a number of years. We support the Bean / Royce legislation for many reasons, not the least of which is its purely voluntary nature – voluntary for companies and agents/brokers, as well as consumers. The bill provides real choice for all participants in the insurance marketplace.

The State of Insurance Regulation

Background

The insurance marketplace has changed and evolved in the millennia since ancient traders devised systems for sharing losses, and in the centuries since the Great Fire of London led to the creation of the first fire insurance company. Indeed, insurance has become increasingly sophisticated and complex since the enactment 60 years ago of the McCarran-Ferguson, which preserved a state role in the regulation of insurance.

In the United States, insurance has historically been governed principally at the state, rather than the national, level. This historic approach, codified by McCarran-Ferguson in 1945, made sense when risks and the impact of losses due to those risks was concentrated in relatively small geographic areas and the insurance markets were similarly small. Initially, risks were generally local and losses were most likely to be felt by the local community. Fire, for example, was a major threat not only to individual property-owners, but to entire communities because of the widespread devastation fire can cause. As populations and economies grew, so did the risks, and the impact of losses became more widespread. The pooling of risks has grown ever wider, and more sophisticated as well.

Initially, state regulation of insurance addressed those needs. The primary objective of insurance regulation has always been to monitor and regulate insurer solvency because the most essential consumer protection is ensuring that claims are paid to policyholders. State regulation initially advanced that goal by giving consumers with no direct knowledge of carriers based in other communities the comfort that they would be able to – and would – pay claims when they came due. This, in turn, led to increased availability and affordability of coverage because carriers were able to expand their reach, making the insurance marketplace more competitive.

But things have changed. While some risks – and insurance markets – remain local or state-based, in general, insurance has become a national and international marketplace in which risks are widely spread and losses widely felt. The terrorist attack on the World Trade Center and the devastation caused by Hurricane Katrina are, perhaps, the two most notable examples, but many policyholders, particularly in the commercial sector, have risks spread across the country and the globe. Rather than encouraging increased availability and improving the affordability of insurance to cover such risks, the state regulatory system does just the opposite. By artificially making each state an individual marketplace, it constrains the ability of carriers to compete and thereby reduces availability and affordability.

Continuing Problems under the Current Regulatory System

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

The states have made some strides in recent years in simplifying and streamlining regulatory requirements. We appreciate that and we continue to work with them to make the system more workable in the modern world. That said, however, the inconsistent, duplicative and often-times conflicting nature of state-by-state regulation plagues our membership. I would like to focus this portion of my testimony on four specific areas that illustrate some of the failings of the current regulatory system: (1) coverage gaps; (2) agent/broker disclosure/transparency; (3) licensure reform; and (4) speed to market issues.

1. Securing Coverage – Current Problems

Arguably the largest shortcoming inherent in the current system is the inability of that system to address coverage gaps and to enhance capacity. The most visible examples of this are the terrorism and natural catastrophe coverage shortfalls. Although Congress has attempted to fill this void with the enactment of TRIA and through its consideration of a variety of solutions to the natural catastrophe coverage issues, those efforts ultimately can serve as no more than band aids that are administered in a regulatory vacuum that attempt to cure perceived symptoms without addressing the fundamental problems. It is difficult or even impossible for the federal government to step into the natural catastrophe void, for example, without having authority to address the regulatory shortcomings related to the underlying coverage it is seeking to augment.

This disconnect can be seen vividly post-Katrina in two very different respects. First, the flood versus wind coverage debates create very real coverage problems for consumers based on the disconnect between the flood component of their coverage and the wind component. It is simply untenable for the federal government to have a flood insurance program that is supposed to work hand in hand with other coverage with which it may not be in synch. Second, some of the affected Gulf Coast states have responded by making their markets even more difficult for carriers to access, exacerbating capacity issues for their residents. It is perhaps for these reasons that the NAIC itself – in testimony given earlier this year – recommended that the federal government administer an all-perils coverage program for homeowners. In essence, the NAIC was recommending a federal system for that component of the business, presumably in recognition of the inability of the states to adequately provide for that sector.

2. Transparency – Well Intended But Inconsistent Requirements

In today's marketplace, it is imperative that insurance brokers be transparent in their business dealings with their clients. The Council has been at the forefront of pushing for the enactment of uniform disclosure rules and regulations. Almost every state imposes explicit requirements on what must be disclosed and when if a broker is both collecting a commission from a carrier and a fee from the client. We embrace this transparency agenda. The problem is that it is virtually impossible to satisfy the differing requirements of the states with a uniform compliance approach. Some states, for example, fully allow the simultaneous receipt of both fees and commissions with disclosure. Other states allow the simultaneous receipt of a commission and a fee for non-placement related services provided that the client is made aware of this and affirmatively agrees to it. Still other states, however, impose a variety of differing limitations, some prohibiting the collection of fees altogether – even in lieu of commissions – on the theory that this may jeopardize their premium tax revenue base.

Some Council members would prefer to move to a compensation model under which their sole compensation comes from fees paid by the client, with no commissions at all. Even though this presumably would be preferred by these members' clients and would completely resolve the issues that the fee/commission transparency requirements endeavor to address, it is essentially impossible to effectuate. This is because many states prohibit insurers from quoting coverage "net" of commission. In some states, the articulated rationale is that this would place some agencies at a disadvantage in the marketplace. In other states, the concern appears to be based more on the overarching desire to ensure that the premium tax revenue base is as broad as possible. In still other states for mandated lines of coverage such as workers compensation, the motivating rationale appears to be the desire to preserve a cost comparison base for future regulated pricing.

Many Council members also assist larger commercial clients with the placement of premium financing. Council members generally disclose that they will be compensated by the lenders for these services. Some states require more explict disclosures. California requires use of a specific form that includes disclosure mandates at odds with those imposed in other states.

Almost half the states also have premium trust fund regulatory requirements. Brokers often collect the premiums on the policies they place and these rules require that premium payments held on behalf of carriers be maintained in separate, segregated accounts. Again, the Council and its members share the ultimate objective of these requirements but again the problem is in the implementation. Some states appear to require that premiums associated with exposures in those states be maintained separately; other states impose express investment and fiduciary limitations on the manner in which the funds are maintained.

For clients with exposures across the nation and their brokers who are endeavoring to serve them efficiently and economically, the differing and conflicting rules and requirements and the inflexibility of their application in some states serves no apparent consumer protection oriented purpose and is at odds with the scope of the activities in which the consumers these states are attempting to protect are engaged.

3. Producer Licensure: Welcome Improvements, but Incomplete Reform

The concrete progress that the States have been able to make in their regulatory reform efforts has primarily been in the producer licensing area – thanks to the enactment of the NARAB provisions included in the Gramm-Leach-Bliley Act (GLBA). NARAB-compliance notwithstanding, there remain several problem areas in the interstate licensing process that impose unnecessary costs on our members in terms of both time and money.

The NARAB provisions included in GLBA 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.

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After enactment of GLBA, the NAIC pledged not only to reach reciprocity, but ultimately to establish uniformity in producer licensing. The regulators amended the NAIC Producer Licensing Model Act (PLMA) to meet the NARAB reciprocity provisions, and their goal is to get the PLMA enacted in all licensing jurisdictions. As of today, nearly all the states have enacted some sort of licensing reform, and the NAIC has officially certified that a majority of states have met the NARAB reciprocity requirements, thereby averting creation of NARAB. This is a good effort, but problems remain; there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions.

Most states retain a variety of individual requirements for licensing, and they all differ with respect to fees, fingerprinting and certifications, among other requirements. Although most of the states have enacted the entire PLMA, a number of states have enacted only the reciprocity portions of the model. Of the states that have enacted the entire PLMA, several have deviated significantly from the model's original language. One state has enacted licensing reform that in no way resembles the PLMA. And two of the largest states in terms of insurance premiums written, Florida and California, have not enacted legislation designed to meet the NARAB reciprocity threshold at all.

The inefficiencies and inconsistencies that remain in producer licensing affect every insurer, every producer and every insurance consumer. Many Council member firms continue to hold hundreds of resident and non-resident licenses across the country. The 183 producers in my firm, for example, hold 183 resident licenses in four states, and 512 non-resident licenses. One of the larger members of The Council holds almost 50,000 resident and non-resident licenses for 5,400 individual producers, and approximately 3,400 resident and non-resident entity licenses for itself and its subsidiaries/affiliates. And this is not a "once and done" deal – state licenses, by and large, must be renewed annually throughout the year, based upon the individual requirements in each state, and there are continuing regulatory requirements and post-licensure oversight that must be attended to, as well. As you can imagine, this requires significant monetary and human resources from each and every producer. This is especially frustrating because, let's face it, the incremental consumer protection value of the tenth or hundredth or thousandth or 50,000th license is questionable, at best.

In addition to the lack of full reciprocity in licensing procedures for non-residents, the standards by which the states measure compliance with licensing requirements differ from state to state, as well. These include substantive requirements – pre-licensing education, continuing education and criminal background checks, for example – as well as administrative procedures such as agent appointment procedures and license tenure and renewal dates.

It also applies to interpretation and application of statutory language. For example, as I have mentioned, most of the states have enacted new producer licensing laws based in whole or part on the NAIC's Producer License Model Act, which was adopted by that organization in 2000. Yet seven years later, the regulators still cannot agree on the meaning of basic – yet critical – terms that are present in every state law, such as what it means to "sell," "solicit" and "negotiate" insurance. Nor can they agree on the meaning of other critical provisions of the law – even when the language in their individual state provisions are identical – word for word. While these may seem like small issues – and individually they may be – taken as a whole, they are significant. It is a bit like Senator Dirksen's take on congressional about spending, but instead of "a billion here and a billion there," we are talking about a regulation here and a rule there.

In addition to the day-to-day difficulties the current regulatory regime imposes, this inconsistent application of law among the states inhibits efforts to reach full reciprocity in producer licensing. As I have mentioned, several states have failed to adopt GLBA-compliant reciprocal licensing regimes, including two of the largest insurance markets – California and Florida. These states, in large part, are disinclined to license as a non-resident a producer whose home state (they believe) has "inferior" licensing standards to their own, even a state with similar or identical statutory language. Thus, they are not reciprocal because they do not trust their fellow states to sufficiently regulate producers. This strikes us as indefensible – regulators defending the system of state regulation of insurance while essentially admitting that consumers in some states benefit from stronger oversight than others.

A third major area in need of streamlining is the processing of license applications. Although a uniform electronic producer licensing application is now available for use in many states – arguably, the biggest improvement in years – several states, including Florida and South Carolina, do not use the common form, and even in states that use the form, there is no common response mechanism. Each state follows up on an application individually, which can be cumbersome and confusing.

More problematic is the fact that every state requires the filing of "additional information" if an applicant responds affirmatively to certain background or other questions on an application. Council members have no objection to the regulators looking into the background of a producer applicant and asking for explanatory information if, for example, a producer has had regulatory or legal issues in the past. We hold ourselves to the highest standards and think the regulators should, as well. Our objection is with the repetitiveness and burdensome nature of the process. The additional information that must be submitted with an application generally must be submitted in paper form (or fax) – it cannot be submitted electronically. Thus, the technological benefit of the uniform electronic application is nullified.

Let me give you an example: We have been attempting to secure a business entity producer license (the necessity of which – in terms of consumer protection – is questionable at best) in a New England state. First, we were required to apply for name approval from the state insurance department, which took several months. After the name was approved, we were required to submit the original paperwork and required documentation to the secretary of state to get the business entity established in the state. This took close to eight months, a length of time that was totally unnecessary. We sent the state the originals of all the required documentation, only to receive copies back from the state saying they needed the originals. Of course, because we had sent them the originals, we only had our copies to work with – so we had to go back to square one and recreate everything. Finally, after nearly a year and the exchange of three sets of "originals" and "copies" of the documents in question with the secretary of state, my staff contacted the state and was told we had been approved. The state made no effort to contact us, and we had never received anything notifying us of our approval. After locating evidence of the secretary of state approval on a government website, we submitted the actual license application to the state insurance department. That was more than three months ago. We have yet to hear back, and all requests result in a response that the application is "in process." As frustrating as this process has been, it has real business implications for my firm. We consistently receive inquiries from carriers looking for proof of licensure in that state.

Another example of unnecessary regulatory burdens comes from a fellow Council member: This brokerage and several of its subsidiaries entered into a settlement with the department of insurance of a northeastern state. The settlement agreement was posted by the department on its website and posted by the broker on its website. Nonetheless, every time the broker or one of the named subsidiaries applied for a license renewal in the state with which it had entered into the settlement, the firm/subsidiary was required to submit a copy of the settlement agreement. Thus dozens, if not hundreds of copies of the settlement agreement were filed with a department that had negotiated and agreed to the settlement and posted the document on its website.

Undeniably, progress in streamlining the producer licensing process has been made since GLBA's NARAB provisions were enacted in 1999. It is clear, however, that despite the revolutionary NARAB achievements, comprehensive reciprocity and uniformity in producer licensing laws remains elusive, and it does not appear the NAIC and the states are capable of fully satisfying those goals. We believe the OFC proposal offers producers a viable alternative to the state system – an alternative that will provide oversight and protections consumers need and demand, and the ease and flexibility that producers need. As an added benefit, as we learned with GLBA and other federal legislation, when Congress acts, the NAIC and states listen. So movement on OFC will put pressure on the states to step up their own regulatory reform activity in an effort to stave off federal intervention. We are already seeing evidence of this at the NAIC, where regulators have established a coalition to take the next step in producer licensing reform. We fully support their efforts and are working with the regulators to achieve results at the state level, but that is no substitute for federal action on the matter.

4. Speed to Market

The state-by-state system of insurance regulation also gives rise to problems for insurers that directly affects the availability of coverage for our clients. Although these problems appear to affect insurance companies more than insurance producers, the unnecessary restraints imposed by the state-by-state regulatory system on insurers ultimately inure to the detriment of our clients and thus harm producers as much as companies because they negatively affect the availability and affordability of insurance, and, thus, our ability to place coverage for our clients.

Most Council members sell and service primarily commercial property/casualty insurance. This sector of the insurance industry is facing severe challenges today due to a number of factors, including: the losses incurred as a result of the September 11 terrorist attacks; increased liability expenses for asbestos, toxic mold, D&O liability and medical malpractice; and years of declining investment returns and consistently negative underwriting results. Some companies have begun to exit 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 exacerbated by the current state-by-state system of insurance regulation.

The current U.S. system of regulation can be characterized as a prescriptive system that generally imposes a comprehensive set of prior constraints and conditions on all aspects of the business operations of regulated entities. Examples of these requirements include prior approval or filing of rates and policy forms. Although the prescriptive approach is designed to anticipate problems and prevent them before they happen, in practice, this approach hinders the ability of the insurance industry to deal with changing marketplace needs and conditions in a flexible and timely manner. This approach also encourages more regulation than may be necessary in some areas, while diverting precious resources from other areas that may need more regulatory attention.

It is also important to note that insurers wishing to do business on a national basis must deal with 55 sets of these prescriptive 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 completely de-regulated 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, significantly impeding the ability of insurers to get products to market. 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. 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.

Let me give you an example that all Council members are familiar with: a few years ago, PAR, an errors and omissions captive insurer sponsored by The Council, sought to revise its coverage form. In most states, PAR was broadening coverage, although in a few cases, more limited coverage was sought. PAR had to re-file the coverage form in 35 states where PAR writes coverage for 65 insureds. After 2 years and $175,000, all 35 states approved the filing. Two years and $5,000 per filing for a straightforward form revision for 65 sophisticated policyholders is unacceptable and is symptomatic of the problems caused by outdated rate and form controls.

We support complete deregulation of rates and forms for commercial lines of insurance. There is simply no need for such government paternalism. Commercial insureds are capable of watching out for their own interests, and a robust free market has proved to be the best price control available. The proposed National Insurance Act contemplates this approach by restricting the federal regulator's authority to dictate rates or the determination of rates.

Insurance Regulatory Reform: Despite recent improvements, the states clearly cannot solve the problems with insurance regulation on their own, so congressional action is necessary.

Although the state insurance regulators, through the NAIC, have attempted to institute regulatory reforms without federal involvement, the reality is that today's marketplace demands far more dramatic action than the states alone are able to provide. As I have mentioned, insurance is no longer the local market it once was. It is a national and international marketplace, the development of which is far outstripping the pace of reform efforts by state regulators and legislatures. The state regulatory system is simply not equipped to handle this increasingly complex and sophisticated marketplace and state boundaries no longer match our clients' national and international business models. Competition and efficiency in the insurance industry lag behind other financial services sectors due to the regulatory inefficiencies and inconsistencies in the state insurance regulatory system. These inefficiencies and inconsistencies must be addressed if the insurance sector is going to be able to keep up with the pace of change in the rapidly evolving global marketplace and thereby provide adequate and affordable coverage to insurance consumers.

The Council regards itself as a pioneer within our industry with respect to regulatory modernization, although 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 (GLBA) several years ago – a first step on the road to insurance regulatory reform. The proposed National Insurance Act is the next step on the road to modernization.

In an effort to get better leverage on the reform options, the Council wanted to see a full, economic analysis of the alternatives for reform. To that end, The Council's Foundation for Agency Management Excellence (FAME) commissioned an independent study of the economic costs and benefits of the various proposals. Our 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. A synopsis of the study is attached to my testimony. I hope it will serve as a useful tool as you consider insurance regulatory reforms.

The FAME study reinforced The Council's long-standing belief that it is critical to the long-term viability of the U.S. insurance industry that regulatory relief is needed, and it is needed now. Broad reforms to the insurance regulatory system are necessary to allow the industry to operate more efficiently, to enable the insurance industry to compete in the larger financial services industry and internationally, and to provide consumers with a strong, competitive insurance market that brings them the best product at the lowest cost.

I want to emphasize at the outset that we are not advocating deregulation of the insurance marketplace or any reduction in consumer protections. What we are advocating – as we did with NARAB and producer licensing reform – is fixing the current regulatory system to allow insurance companies and producers to have a choice between state and federal oversight. Many insurers and producers will likely choose to remain within the state system because it works best based on the size of their business and their customer base. For the same reasons, others will choose the federal option. For this latter group, jettisoning the current multi-state system for a single federal regulator makes eminent good sense, allowing them to avoid the overlapping, burdensome dictates of 55 jurisdictions for a single regulator and thereby easing regulatory burdens – and doing so without sacrificing consumer protections. We believe the long-term effects of such reform on the marketplace will ultimately benefit the consumer by increasing capacity and improving availability of coverage.

Studies have shown that the regulatory modernization efforts attempted 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 follows that there is no guarantee the state-based system will adopt further meaningful reforms without continued external threats to the states' jurisdiction. Too much protectionism and parochialism interferes with the marketplace, and the incentive for reform in individual states simply does not exist without a federal threat. Thus, congressional involvement in insurance regulatory reform is entirely in order and, in fact, overdue. Broad reforms to the insurance regulatory system are necessary to allow the industry to operate more efficiently, to enable the insurance industry to compete in the larger financial services industry and internationally, and to provide consumers with a strong, competitive insurance market that brings them the best product at the lowest cost.

1. Surplus Lines Insurance and Risk Retention Groups

In the last several years, high rates for property and casualty insurance have been a serious problem for many mid-sized and larger commercial firms. Hard markets such as these cause availability to decrease and the cost of coverage to increase. During these periods, insureds – particularly sophisticated commercial insureds – are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage options and hold down costs. There are two excellent mechanisms in place that offer such alternative markets: surplus lines insurance and risk retention groups. Although surplus lines insurance and insurance purchased through risk retention groups technically are less regulated than insurance in the admitted market, there are, nonetheless, state regulatory requirements and federal laws that apply to these alternative market mechanisms that prevent this marketplace from fully realizing its potential.

As we have mentioned, The Council strongly supports the surplus lines reform that has passed the House and is now under consideration in the Senate and believes such legislation will not detract at all from the debate over the OFC, nor is a substitute for that legislation. In fact, we believe it will help set the stage for creation of an optional federal charter.

Risk Retention Groups (RRGs) 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. 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 law – 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.

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." The Council supports expanding the LRRA to allow RRGs to write property as well as liability coverage to enhance their ability to increase the availability of commercial insurance.

2. An Optional Federal Charter

Having said that, however, we believe the ultimate solution is enactment of legislation creating an optional federal insurance charter as contemplated in the National Insurance Act. An OFC regime would enhance the surplus lines and risk retention group reforms and support their further extension through the commercial marketplace. An optional federal charter also would give insurers and producers the choice between a single federal regulator and multiple state regulators. It would not dismantle the state system, rather it would complement the state system with the addition of a federal partner. It is likely that many insurers and producers – particularly those who operate in a single state or perhaps a small number of states – would choose to remain state-licensed. Large, national and international companies, on the other hand, would very likely opt for a federal charter, thereby relieving themselves of the burden of compliance with 55 different regulatory regimes.

The National Insurance Act creates an optional federal regulatory structure for both the life and property & casualty insurance industries; that option extends equally to both insurance companies and insurance agents and brokers (producers); and the bill carefully addresses essential elements of insurance regulation including licensure, rate approval, guaranty funds, and state law preemption. The Act preserves the state system for those that choose to operate at the state level, but offers a more sophisticated regulatory structure for insurers and producers that operate on a national and international basis in this increasingly global industry.

- ***H.R. 3200 creates a truly optional insurance regulatory system for all industry players.*** The structure it creates gives insurance companies and producers a real choice as to whether they want to operate under federal or state oversight. The Act preserves the ability of insurers and insurance producers to operate under state licenses, while giving both the option of doing business under a single federal license.

- ***H.R. 3200 gives insurance producers a choice between federal and state oversight, and in no way increases regulatory burdens on producers.*** Far from creating additional licensure and other regulatory requirements for insurance producers, the Act has the potential of significantly reducing the regulatory burdens producers face. Under the Act, for example, federally licensed producers would be subject to a single set of disclosure and other consumer protection requirements. Insurance producers also can choose to keep their existing state licenses and sell for all insurers – state and national – wherever they hold a state license. Or they can choose a single national license and sell for all insurers – state and national – in all U.S. jurisdictions. An additional benefit for producers that choose a national license is that they would be subject to a single set of requirements covering qualifications to do business, testing, licensing, market conduct and continuing education. Although the states have taken some steps in recent years toward uniform and reciprocal producer licensing requirements, it will be many years before they will enjoy such a streamlined system at the state level – if ever.

- ***Insurance consumers, too, have a choice.*** Consumers retain complete control to choose the insurers and producers with which they wish to do business. If a consumer deems it important that their insurance company be subject to the rules of a particular state or the federal regulator, they can use that as a factor in their purchase decision.

- ***Consumers' product choices will expand.*** A single federal regulator for national insurers will give insurance consumers expanded product choices. By offering an alternative to the multiple-state regulatory hoops that insurers must now jump through, the federal charter will enable insurers to get products to market in a more streamlined fashion. This will enable them to address consumers' needs more quickly and more specifically with products tailored to consumer needs.

- ***H.R. 3200 bolsters rather than diminishes current protections for insurance consumers.*** At present, insurance consumer protections are uneven from state to state. Some states have a robust system of consumer protection, while others devote fewer resources to it. Under the Act, consumers purchasing products from national insurers would have the same protections and rights whether they live in Los Angeles, Topeka or Providence. Importantly, their rights under a policy would not change simply because they move across the Potomac from Washington to Alexandria.

- ***The consumer protections in H.R. 3200 are stronger than those in many states and provide protections that are simply unavailable in many states.*** For example, the Act requires every insurer to undergo both a financial and a market conduct examination at least once every three years. In addition, the Act provides for the creation of a Division of Fraud, Division of Consumer Affairs, and an Office of the Ombudsman to protect consumers. The Act makes the commission of a "fraudulent insurance act" a federal crime and subjects National Insurers to federal antitrust laws.

- ***The Act provides for comprehensive, rigorous oversight of insurers and insurance producers that protects producers in case of insolvency and is comparable to the best practices currently in place in the states.*** In addition to traditional consumer protections, the Act protects insurance consumers in another essential way: federally-chartered insurers will be subject to the financial solvency oversight of a federal regulator with the resources and staff to adequately supervise large corporations that may be beyond the capability of the states. The Act provides for financial and market conduct examinations every three years, allows for self-regulatory organizations to be created to police the industry, ensures that sufficient resources and federal attention will be devoted to insurance oversight, and does not eliminate or reduce in any way the ability or effectiveness of state insurance regulation. In addition, H.R. 3200 leaves the state guaranty system intact to ensure that policyholders are protected in case of insurer insolvency. The Act sets stringent standards that state funds must meet in order to secure national insurer participation. A national guaranty fund is established to protect policyholders in states where the guaranty fund falls short of the national standards.

The Council has been a strong advocate for legislation such as the National Insurance Act for decades. We realize this is a major undertaking with a great number of issues to be resolved. Political reality dictates that it will not be an easy process, nor will it be quick. We look forward to being a constructive voice in this debate.

In closing, and as I noted above, despite its ambitious reform agenda, the NAIC is not in a position to force dissenting states to adhere to any standards it sets. Moreover, in many ways the business of insurance – and the consumers that business needs to serve – have moved beyond artificial state boundaries and it is long past time that the regulation of that business move beyond those artificial boundaries as well. On behalf of The Council, I thank you for your genuine interest in these issues. We stand ready to assist you in any way.

# # #

American Insurance Association

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING ON

"THE NEED FOR INSURANCE REGULATORY REFORM"

OCTOBER 3, 2007

WRITTEN STATEMENT OF

WILLIAM MCCARTNEY

THE USAA GROUP

ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Chairman Kanjorski, Ranking Member Pryce and Members of the Subcommittee: Good afternoon. My name is Bill McCartney, and I am Senior Vice President, Government and Industry Relations at the United Services Automobile Association (USAA) Group, a national, highly competitive, and fully integrated financial services company headquartered in San Antonio, Texas. Through its 22,000 employees, USAA provides insurance, banking, and investment products to over 6 million current and former members of the U.S. military and their families. In fact, USAA's mission, to which we devote our undivided attention, is "to facilitate the financial security of our members, associates and their families through provision of a full range of highly competitive financial products and services." The company's net worth is greater than $13 billion and USAA owns or manages assets exceeding $133 billion. USAA is known for its financial strength and outstanding service to its members, and has received numerous awards for customer service, privacy practices, employment for women, and support for our troops.

I am here to testify today on behalf of USAA and our property-casualty insurance trade association, the American Insurance Association (AIA), and its more than 350 members. We want to thank the Subcommittee for addressing an issue that is vitally important to the country, to USAA, and to AIA: the compelling need to modernize today's outdated and dysfunctional state insurance regulatory system.

The issue of insurance regulation, once thought to be the province of isolated industry practitioners and regulators, is now central to many of the critical public policy debates, including protection against natural catastrophes, national economic security in the face of man-made catastrophes such as terrorism, and the financial strength and international competitiveness of the U.S. financial services sector. Moreover, insurance regulation is a significant topic of public concern because the U.S. financial services sector, in which insurance plays an important role, is the engine that drives our economy. Within this sector, insurance plays a unique role because it helps individuals and businesses assume the risks that are essential in life and business with the security of a strong financial safety net in place in the event of loss. Without insurance, societal innovations and advancement become more risky and less likely to become reality.

Today, we stand at a regulatory crossroads that may well determine the future of the insurance marketplace in the 21st century, its ability to respond effectively and efficiently to losses – catastrophic or otherwise – and the appropriate role of government. With this context in mind, I would like to share three observations about the property-casualty insurance system:

1. Our economy is not static and continues to become more complex every day. Consumer needs continue to expand and grow in conjunction with our economy. These evolutions have surpassed the current insurance regulatory environment's effectiveness and viability.

2. The current regulatory system inhibits innovation and international competitiveness. According to two major reports on global competitiveness in the financial services industry (Schumer/Bloomberg and the U.S. Chamber), U.S. insurers wishing to operate on the world stage are hampered by restrictive regulation that their foreign competitors do not face.

Moreover, the flow of new capital in our industry is moving in one direction—offshore to jurisdictions with more rational regulatory systems.

3. A market-based *optional* federal charter can benefit consumers by reforming regulation and encouraging innovation, while retaining the state regulatory system for companies that wish to remain there.

USAA and AIA's other member companies firmly believe that state-based regulation has not worked effectively or efficiently. It does not allow the insurance industry to meet the needs of Americans or the businesses they run, but instead perpetuates a structure that breeds inefficiency and inconsistency, and is passively hostile to healthy, competitive markets and the U.S. consumers that rely on those markets. Costs inherent in state insurance regulation burden our members when they change policies, as is necessary when they are ordered to change residences (once every 18 months on average), often within days. Members of the U.S. Armed Forces should not be inconvenienced by the unnecessary regulatory roadblocks that the state-based system places in their way; nor should our civilian members, or other insurance policyholders, in today's modern, global economy.

Experience Demonstrates the Critical Need for Insurance Regulatory Reform

I would like to focus today on those aspects of the state system that impede USAA and its members – and, frankly, all insurers and their consumers – from enjoying the full benefits offered by a market-oriented and uniform regulatory structure. I speak about the states' regulatory shortcomings from "inside" experience. By way of background, from 1987 to 1994, I was Nebraska's Director of Insurance and was privileged to serve as President of the National Association of Insurance Commissioners (NAIC) in 1992. I have always believed that the primary and overarching focus of insurance regulation must be the financial condition of insurance companies. And I used to believe that the states could achieve uniformity and consistency of regulation without federal intervention.

During a hearing before the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee in the early 1990's, I asked Congress to give states the time necessary to effect the changes that we had identified. I also said that, if the states proved unable to make those changes, I would be the first to admit it to Congress. It's been 15 years, but here I am.

I still have many friends engaged in the regulation of insurance in the states, and this is not an indictment of the people who toil in state regulation. Most of them are very professional and want to do the right thing, but they labor under a framework that has not been meaningfully changed in more than 62 years. Even when the regulators are unanimous in their view of what needs to be done to address a national issue, it is impossible to implement it nationally. Excluding the District of Columbia and the US Territories, we have 50 separate regulatory agencies and 99 legislatures (Nebraska's Unicameral only counts once; the other states count twice). Experience has shown that it is close to impossible for an NAIC model law to be uniformly enacted nationally. That may not have been much of a problem in 1945—the last time Congress fundamentally addressed insurance regulation by enacting the McCarran-Ferguson Act. Back then, most people resided in one state for their entire lives.

Much in this country has changed since then—great societal, economic, and technological changes. Society has become highly mobile. This is especially true of USAA's members. Each year, a third of our active duty members undergo a move. For most of the financial products they have with USAA, a simple change of address form is all they need. But for their property and casualty products, that's only the beginning. Even though their risk profile has not changed because of the move, they can't take their automobile insurance and homeowners or renters policies with them as they can their credit cards and investment products. A move means a complete re-underwriting, re-pricing, and re-issuance of their property and casualty products and it also generally means different coverages in the new state than what they had in the state they just left.

Some argue that, because state tort laws, property risks, automobile insurance requirements (and, on the commercial insurance side, workers compensation laws) are so state-specific, a national regulator for property and casualty insurance products could never work. I strongly disagree. USAA, and I believe this to be true for other insurers, could readily develop standardized products that we could offer to our members that take into account all these state variations. The reason insurers have not done so—and the reason for an almost complete lack of innovation in this industry—is because it is so difficult and time-consuming to gain national approval of the innovations. Robert Kennedy used to favorably quote George Bernard Shaw who wrote, "Some people see things as they are and ask 'Why?'; I dream things that never were and ask 'Why not?'" When it comes to insurance regulation, it is time for us to look for significant reform and ask ourselves, "Why not? Why are we continuing to do things as we did them 60 years ago?"

The NAIC will point to a number of initiatives that the states have undertaken to modernize insurance regulation as proof that the states are going to make the meaningful changes necessary to bring regulation into the 21st Century. While the NAIC is to be commended for trying, the proof is in the pudding, and the results of all of those efforts can be best summed up by the title of a Shakespeare play: *Much Ado About Nothing*. I know, because I was part of those efforts for seven years and have been watching the NAIC's fits and starts at reform since then.

Take, for example, the Interstate Insurance Product Regulation Commission (IIPRC), which just completed its first year of operation. The NAIC is pleased that 30 jurisdictions (29 states and Puerto Rico) are now members of the IIPRC. However, 21 states, including five large states—California, Florida, Illinois, New Jersey, and New York—have not joined (and the regulators in some of those states have stated that they never will join). In addition, the compact only deals with "asset protection insurance products, such as life insurance, annuities, disability income and long-term care insurance." The products offered by members of the AIA fall outside the IIPRC. While the IIPRC was created to "serve as a central filing point . . . enhancing the speed and efficiency of regulatory decisions and allowing companies to compete more effectively in the modern financial marketplace while continuing to provide protection for consumers," it adds a layer of bureaucracy and expense without reducing bureaucracy and expense in the state insurance departments.

Similarly, the NAIC points to its System for Electronic Rate and Form Filing (SERFF) (which does handle property and casualty insurance products) as evidence of its success in streamlining and modernizing insurance regulation. Again, while the NAIC must be commended for trying, the results have been mixed. While all 50 states, the District of Columbia, and two of the Territories have signed on to participate in the system, not every state allows all types of filings to be made through SERFF. SERFF was designed to be a single point of filing that would streamline the approval process; however, many states retain state-specific requirements that insurers must complete in addition to the generic SERFF form. How does it work in reality? Recently, USAA amended its auto policy to provide an online driver discount. We were required to file the change with every state. The filing was made through SERFF and, by the time all of the state forms were included, ran to one thousand pages. Because of its voluminous nature, I have not copied it as an exhibit to my testimony; however, you can draw your own conclusion whether or not a regulatory modernization and streamlining initiative that still requires a thousand pages of filings has been the success the NAIC claims.

While the NAIC has initiated other steps to modernize insurance regulation, to varying degrees of success, one in particular has had a very negative impact on USAA. When Gramm-Leach-Bliley was enacted in 1999, it contained a provision designed to modernize insurance regulation. It required states to achieve uniformity or reciprocity in their licensing of non-resident insurance producers. Unfortunately, the NAIC was given latitude in how to achieve this and the course chosen greatly added to the regulatory burden at USAA, which markets products directly to our members, principally over the internet and by telephone. At the time the regulatory "reforms" were implemented by the states, USAA maintained roughly 33,400 total producer licenses. Today, that number has increased more than six times to nearly 205,000 licenses. That can hardly be viewed as regulatory streamlining and modernization.

While I have spent much of my time here today talking about the problems of inconsistency and non-uniformity in the state regulatory system, for property-casualty insurers, the states' obsessive focus on government price and product controls is just as damaging to the competitive structure of the marketplace. I have always thought that the only function of regulatory oversight of insurance rates was to make certain that they are not imperiling an insurer's solvency—the primary and overarching role of insurance regulation. But, over the course of my 30-year career in insurance, I have come to know that the existing regulatory approach at the state level is misguided; that the system of price and product controls empowers regulators, not consumers; that uniformity and consistency are not possible without federal intervention; and that continuing the current system will drive companies out of business and capital out of the United States.

Additionally, the unwieldy and misfocused nature of the regulatory system is contributing to the outflow of risk-bearing capital from the U.S. to jurisdictions with more rational and predictable regulatory systems. According to the CEO of one major offshore reinsurance company, a major consideration in choosing a domicile is the regulatory freedom it grants while still maintaining "a credible regulatory environment and a sound operational infrastructure." Virtually all of the new capital that has entered the U.S. market since Hurricane Katrina has been domiciled in Bermuda, whose regulatory system "allowed reinsurance companies to enter the market on a timely basis. This was not possible in the United States under the highly fragmented and difficult state insurance regulatory system." This attitude speaks volumes about the competitiveness of the U.S. insurance industry under the current regulatory system and its less than promising future in our global economy if significant reform is not enacted.

A Better Regulatory Alternative

It is high time for a change. We believe that an optional federal charter approach, which relies on a combination of free markets and a tightly re-focused regulatory system, represents our best opportunity to advance regulatory modernization that works for consumers, the industry, and the economy. This is a regulatory system that has worked well in the banking industry for well over a century, and will modernize the insurance industry if adopted.

We strongly support the National Insurance Act of 2007 (H.R. 3200), introduced in July by Reps. Melissa Bean (D-IL) and Ed Royce (R-CA), along with its Senate counterpart. This legislation would modernize insurance industry regulation by providing an optional federal charter (OFC) for insurers that choose to be regulated at the federal level, while keeping the state-based regulatory system in place for companies that choose to remain state-regulated. For national companies, an optional federal charter would displace the current multi-state patchwork regulatory system with a national framework that provides uniformity, consistency, and clarity of regulation—thus allowing them to meet the consumer demands and operational imperatives of the 21st century. H.R. 3200 embodies all of the elements of this paradigm and represents the best approach for Congress to move forward in advancing reform.

H.R 3200 does not regulate prices charged by market participants, because it recognizes that governments, acting unilaterally in these areas, cannot be effective surrogates for the free market. Free market pricing has been successful in virtually every other industry within the financial services sector, as well as the few states where insurance rates are lightly regulated or not regulated at all.

As a substitute for price controls, H.R. 3200 places regulatory emphasis on ensuring that companies are financially sound and that consumers are protected from misconduct by market participants. These are core regulatory functions for most industries, and insurance should be no exception. In addition, the optional federal charter would bring needed uniformity for those choosing a national license, while respecting the decisions of others to remain under state regulatory authority.

Thus, H.R. 3200 effectuates a fundamental shift in regulatory application. At the same time, H.R. 3200 does not preempt state premium tax regimes or abandon aspects of the state system that are necessary for consumer protection. In this respect, the Act recognizes that there always will be a need for markets of last resort – so-called "residual markets" – and that national insurers must participate in those markets when participation is mandated by state

law. In addition, the Act requires national insurer participation in state-mandated statistical and advisory organizations, and workers' compensation administrative mechanisms.
By de-emphasizing those aspects of regulation that tend to politicize insurance and weaken the private market, H.R. 3200 establishes stronger, re-focused regulation in those areas where regulation is necessary to protect consumers as they navigate the system. Above all, enactment of H.R. 3200 will assure that the insurance safety net remains strong despite the ever-changing nature of risk.

For insurance consumers, the Act establishes both a federal ombudsman to serve as a liaison between the federal regulator and those affected by the regulator's actions, as well as consumer affairs and insurance fraud divisions to provide strong consumer service and protection.

Over the long-term, it is our view that a federal regulatory option, structured in the way set forth in H.R. 3200, will modernize regulation of the industry, empowering consumers and emphasizing market conduct and financial solvency oversight in the process. In creating these needed systemic reforms, the Act will consolidate regulation into a single uniform point of enforcement for those that choose the federal charter, without forcing change for those remaining in the state system.

The Critical Need to Move Forward

Insurance regulatory reform is not an academic exercise; it is a critical imperative that will determine the long-term viability of one of our nation's most vital economic sectors, and help define how our economy manages risk in the future. The choice is between the existing state regulatory bureaucracy or a new approach that relies on the hallmarks of the free market and individual choice and recognizes the evolution of consumers' needs in our global economy.

As the Subcommittee considers reform of the current system, we believe that the three basic principles that define the optional federal charter approach in H.R. 3200 must be followed:

✓place primacy on the private market, not regulatory fiat, creating an environment that empowers consumers as marketplace actors;

✓focus government regulation on those areas where government oversight protects consumers in the marketplace, such as financial integrity and market conduct, rather than on those activities that distort the market, such as government price controls and hostility to innovation; and

✓ establish uniform, consistent, and efficient regulation.

We believe it is very important for the Subcommittee to judge any reform proposal against these principles to ensure that any legislation that may be enacted does not create or add more unnecessary regulatory burdens, does not inadvertently restrict the options that a vibrant private market can offer to consumers, and adds efficiency and strength to insurance regulation.

Creating an optional federal charter is imperative to meet the needs of customers and insurers, alike. We appreciate your interest in this important subject and look forward to working with you to improve our nation's insurance regulatory system. Thank you for the opportunity to appear before you today.

Independent Insurance Agents
& Brokers of America, Inc.

STATEMENT OF ALEX SOTO
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, GOVERNMENT SPONSORED ENTERPRISES, AND INSURANCE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

October 3, 2007

Good afternoon Chairman Kanjorski, Ranking Member Pryce, and Members of the Committee. My name is Alex Soto, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA). Thank you for the opportunity to provide our association's perspective on insurance regulatory reform. We welcome an open discussion and debate on this very important topic. I am the Immediate Past Chairman of IIABA, and I am also President of InSource, which is an agency that was formed from a merger of three of Miami's oldest insurance agencies. Through our practice specialties, InSource has made a long-term and total commitment to our South Florida community.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we are a network of more than 300,000 agents, brokers, and employees nationwide. IIABA represents small, medium, and large businesses that offer consumers a choice of policies from a variety of insurance companies. Independent agents and brokers provide a variety of insurance products – property, casualty, health, life, employee benefit plans and retirement products.

Introduction

It is clear that there are inefficiencies today in the regulation of insurance, and there is growing consensus that the state system of insurance needs to be modernized. There is disagreement, however, on the most effective and appropriate way to achieve reform. Some support pursuing reform in the traditional manner, which is to seek legislative and regulatory improvements on an ad hoc basis in the various state capitals. Another approach, that some international and large domestic insurance companies advocate, would establish a federal insurance bureaucracy to regulate the insurance industry through "optional" federal chartering. Others, such as IIABA, support a pragmatic middle-ground approach that uses targeted federal legislation only where necessary, while maintaining and improving the existing system of state insurance regulation.

As we have for over 100 years, IIABA supports state regulation of insurance – for all participants and for all activities in the marketplace – and we oppose any form of federal regulation, optional or otherwise. Yet despite this historic and longstanding support of state regulation, we do not believe the state system can appropriately and effectively address certain of its problems on its own. That is why we feel that there is a vital role for Congress to play in helping to modernize the state regulatory system and overcome the obstacles to reform that currently exist; however, such an effort need not replace or duplicate at the federal level what is already in place and working well at the state level. Through targeted federal legislation along the lines of H.R. 1065, the Nonadmitted and Reinsurance Reform Act, which the House passed by voice vote this summer, we can streamline and modernize the state-based system without having to take the drastic step of creating a new federal agency.

During this discussion of potential insurance regulatory reform, we must recognize, and we ignore at the marketplace's peril, that the current state system of insurance regulation does have significant strengths – particularly in the area of consumer protection. State insurance regulators have done an excellent job of ensuring that insurance consumers, both individuals and businesses, receive the insurance coverage they need and that any claims they may experience are paid. These and other aspects of the state system are working well. The "optional" federal charter concept proposed by some would displace the components of state regulation which work well and, in essence, "throw the baby out with the bathwater."

To explain the rationale for our support of targeted legislation to achieve insurance regulation reform, I will first offer an overview of both the positive and negative elements of the current insurance regulatory system. I will then provide a more complete explanation of the approach that we believe offers the most appropriate vehicle to modernize and improve the state-based regulatory system. I will then outline the reasons for our strong opposition to proposals to create an "optional" federal charter for insurance.

The Current State of Insurance Regulation

From the beginning of the insurance business in this country, states have carried out the essential task of regulating the insurance marketplace to protect consumers. The current state insurance regulatory framework began in 1851 when New Hampshire appointed the first insurance commissioner. Insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved.

State regulation of insurance has been reaffirmed as recently as 1999 through the Gramm Leach Bliley Act (GLBA). Specifically, Title III of GLBA unequivocally provides that "[t]he insurance activities of any person (including a national bank exercising its powers to act as agent . . .) shall be functionally regulated by the states," subject only to certain exceptions which are intended to prevent a state from thereby frustrating the affiliation policy adopted in GLBA. The GLBA provisions collectively ensure that state insurance regulators retain regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. These mandates are intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Most observers agree that state regulation works effectively to protect consumers, largely because state officials are positioned to be responsive to the needs of the local marketplace and local consumers. Unlike most other financial products, which are highly commoditized, the purchaser of an insurance policy enters into a complex contractual relationship with a contingent promise of future performance. Therefore, the consumer will not be able to determine fully the value of the product purchased until after a claim is presented – when it is too late to decide that a different insurer or a different product might make a better choice. When an insured event does occur, consumers often find themselves in a crisis, facing many challenging issues and perplexing questions; as a result, they must have quick and efficient resolution of any problems, and a local call works best.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each state, and the policies themselves are contracts written and interpreted under the laws of each state. Consequently, the constitutions and statue 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 of experience interpreting and applying these state laws and judgments. 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 require local officials "on the beat."

Protecting policyholders against excessive insurer insolvency risk is one of the primary goals of state insurance regulation. If insurers do not remain solvent, they cannot meet their obligations to pay claims. State insurance regulation gets high marks for the financial regulation of insurance underwriters. State regulators protect policyholders' interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs. The states, through the National Association of Insurance Commissioners (NAIC), have developed an effective accreditation system for financial regulation that is built on the concept of domiciliary deference (the state where the insurer is domiciled takes the lead role). When insolvencies do occur, a state safety net is employed: the state guaranty fund system. States also supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase products and file claims.

Targeted Insurance Regulatory Reform

Despite its many benefits, state insurance regulation is not without its share of problems. As I mentioned earlier, there is general agreement among both policymakers and the private sector that insurance regulation needs to be updated and modernized. While the existing system does have many benefits, it also has been rightly characterized as slow and inefficient with different laws and regulations in some areas that add unnecessary expense. These criticisms are accurate, and there is a desperate need for a common-sense solution. Therefore, while we do continue to strongly support the state system, we question whether the states will be able to resolve their problems on their own. For the most part, state reforms must be made by statute, and state lawmakers inevitably face practical and political hurdles and collective action challenges in their pursuit of improvements on a national basis.

We believe that congressional legislative action is necessary to help reform the state regulatory system. We propose that two overarching principles should guide any such efforts in this regard. First, Congress should attempt to fix only those components of the state system that are broken. Second, no actions should be taken that in any way jeopardize the protection of the insurance consumer, which is the fundamental objective of insurance regulation and of paramount importance to IIABA and its members.

IIABA believes that the best method for addressing the deficiencies in the current system is a pragmatic, middle-ground approach that utilizes targeted legislation or federal legislative "tools" to establish greater interstate consistency in key areas and to streamline the often redundant oversight that exists today at the state level. By using targeted and limited federal legislation on an as-needed basis to overcome the structural impediments to reform at the state level, we can improve rather than dismantle the current state-based system and in the process produce a more efficient and effective regulatory framework. Rather than employ a one-size-fits-all regulatory approach, a variety of legislative tools could be employed on an issue-by-issue basis to take into account the realities of today's marketplace. This can be accomplished through enactment of a number of bills dealing with particular aspects of insurance regulation starting with those areas in most need of reform where bipartisan consensus can be established.

Congress's work in this area need not jeopardize or undermine the knowledge, skills, and experience that state regulators have developed over decades. While IIABA believes such a proposal must modernize those areas where existing requirements or procedures are outdated, it is important to ensure that this is done without displacing the components of the current system that work well. In this way, we can assure that insurance regulation will continue to be grounded on the proven expertise of state regulators at the local level. Targeted federal legislation addresses limited aspects of state insurance regulation only where uniformity and greater consistency is truly necessary and is the least intrusive option. Unlike other ideas, such as an "optional" federal charter, this approach does not threaten to remove a substantial portion of the insurance industry from state supervision and effectively preempt all application of state law.

Some have criticized the targeted federal legislative approach because of enforcement concerns. The reality, however, is that court enforcement of federal preemption occurs regularly and would occur under both the federal tools approach and in other proposals such as the "optional" federal charter. As long as federal reform legislation is properly crafted and clear, enforcement of national standards would not create more burdens for the court system.

As evidence of the viability of this approach, targeted legislation to reform an aspect of the insurance industry has already passed the House of Representatives. In June of this year, H.R. 1065, the Nonadmitted and Reinsurance Reform Act of 2007, introduced by Reps. Dennis Moore and Ginny Brown-Waite passed the House by voice vote. Similar legislation was passed by this Committee and by the full House in a unanimous vote last year. This legislation would apply single-state regulation and uniform standards to the nonadmitted and reinsurance marketplaces and give sole regulatory and enforcement authority to the insured's home state for the placement of non-admitted insurance. Unlike other reform proposals, this legislation has near-unanimous industry support and, as evidenced by the vote in the House in June, strong bipartisan congressional support. We applaud the cosponsors for introducing this legislation and the full House for its prompt passage of this important bill. This model, federal legislation modernizing state regulation, can be used to reform other aspects of the insurance market.

An additional area where targeted reform could be achieved is in the area of agent licensing. One of the most significant elements of GLBA for the insurance marketplace is the inclusion of the National Association of Registered Agents and Brokers (NARAB) Subtitle, which was intended to produce meaningful producer (i.e., agent and broker) licensing reform in a timely manner. Agents and brokers across the country hoped effective reform was imminent following GLBA's passage and the subsequent adoption of the NAIC's Producer Licensing Model Act (PLMA) by most jurisdictions, but we are still awaiting the promised benefits more than seven years later. Congress's action in 1999 certainly had the intended effect of spurring state action, but critical problems remain because the standards were not sufficiently clear, the bar was not high enough, and many states are not complying with the GLBA and PLMA standards.

While the NAIC has cited the "progress" made in the licensing arena as one of its most notable success stories, our members remain frustrated by the many challenges and burdens they face and are increasingly impatient with the lack of progress. The most serious challenges facing agents are the redundant, costly, and sometimes contradictory requirements that arise when seeking licenses on a multi-state basis, and the root cause of these problems is the failure of many states to issue licenses on a truly reciprocal basis. The PLMA and the GLBA clearly outline the limits of what may be required – *a nonresident in good standing in his/her home state shall receive a license if the proper application or notice is submitted and the fees are paid* – yet states continue to impose additional conditions and requirements.

The current licensing system is cumbersome, confusing, burdensome, and time-consuming, and it hinders the ability of agents and brokers to responsively address the needs of insurance purchasers. In most states, a nonresident must obtain three separate licenses – an individual license, an agency license, and a foreign corporation registration in each jurisdiction – in order to engage in insurance producer activities in a particular state, and these duplicative and redundant layers of licensing requirements do not benefit consumers in any meaningful respect. These and other challenges make producer licensing an area ripe for renewed congressional action. Targeted federal legislation that would ensure a completely reciprocal licensing process for producers would provide a more competitive insurance market and improve the state-based system of insurance. Additionally, such federal legislation would preserve the rights of states to license, supervise and discipline insurance producers. We look forward to working with the Committee on such legislation.

An additional area ripe for targeted reform is the product approval process. For life products, federal legislation could build upon the NAIC's interstate compact for approval of life, disability, and long-term care products. For property/casualty products, targeted legislation could facilitate the establishment of a coordinated electronic system for nationwide single point of filing, common filing nomenclature to reduce unnecessary forms filings and deviations, eliminate all unpublished desk-drawer rules, and expedite review of forms through established and enforceable time deadlines.

As I have mentioned, while there are areas of the insurance marketplace that are in need of reform, there is not a wholesale national crisis that requires such a drastic remedy as optional federal regulation (which is discussed in detail below). In addition to targeted reform, where there are significant market problems we welcome measures such as H.R. 2761, the Terrorism Risk Insurance Revision and Extension Act, and H.R. 3355, the Homeowners' Defense Act. These bills address specific problems, terrorism and natural disaster insurance issues - two areas where there has been market failure. Addressing specific problems where necessary without disrupting the entire insurance market is the appropriate way to handle such problems, and we applaud the Committee for passing both of these bills.

I want to again thank the sponsors for introducing the Nonadmitted and Reinsurance Reform Act and the House for taking such prompt action in passing this legislation. We are hopeful that this approach will be used in the near future to facilitate additional reforms in the state-based system of insurance regulation, particularly in the area of producer licensing.

"Optional" Federal Charter

I would be remiss if I did not discuss briefly our strong opposition to another suggested method to achieve insurance regulatory reform – the proposal to create a parallel and duplicative federal system of regulation by providing for an "optional" federal charter (OFC) for insurance. We are very concerned about this proposal for full-blown "optional" federal regulation of the insurance industry and believe that it would not reform the current system but would supplant and eviscerate the state system of insurance regulation.

Creating an industry-friendly "optional" regulator, as current OFC legislation provides, is at odds with one of the primary goals of insurance regulation, which is consumer protection. 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 policies, it is very easy for me to contact 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 will be as responsive to a consumer's needs as a local regulator.

This is because the federal regulatory model proposes to charge a distant (and likely highly politicized) federal regulator with implementation and enforcement. Such a distant federal regulator may be completely unable to respond to insurance consumer claims concerns. As a consumer, personal or business, there would be confusion as to who regulates policies, the federal government or the state insurance commissioner, and how coverages apply. I could have a single client with several policies with one company regulated at the federal level, while at the same time having several other policies which are regulated at the state level. As an agent representing clients with policies regulated at the federal and state level, though, I would be forced to understand both regulatory systems and deal with the federal government, even if I wanted to remain licensed only in my home state.

Although the proposed "optional" federal charter regulation arguably could correct some deficiencies, the cost is incredibly high. A new federal regulator would add to the overall regulatory infrastructure – especially for independent insurance agents and brokers selling on behalf of both state and federally regulated insurers – and undermine sound aspects of the current state regulatory regime. Even though it is commonly known as "optional," current federal legislative proposals to allow for such a federal insurance charter would not be at all optional for agents. Independent agents represent multiple companies, and, under this proposal, presumably some insurers would choose state regulation and others would choose federal regulation. In order to field questions and properly represent consumers, independent agents would have to know how to navigate both state and federal systems, therefore making them subject to the federal regulation of insurance – meaning OFC would not in any way be optional for insurance producers. Even more importantly, "optional" federal charter would not be optional for insurance consumers. The insurance company, not the insurance consumer, would make that determination.

Again, IIABA believes that local insurance regulation works better for consumers and the state-based system ensures a level of responsiveness to both consumers and the agents who represent them that could not be matched at the federal level. OFC proposals attempt to address this concern by providing for the establishment of federal regional offices. However, to match the local responsiveness of state regulators, a federal office would have to be established in every state, and in many cases, multiple offices within each state. This would create an entirely new and completely redundant federal regulatory layer. Why duplicate the current state-based system when you can build off its strengths and modernize it? There is no way out of this predicament for the supporters of OFC – either you significantly increase the size of the federal government to match state regulators' responsiveness to consumers or rely upon a distant federal regulator in Washington, D.C. to meet consumer needs – and they will fail to meet those needs. Additionally, an OFC would weaken the authority of state officials to protect consumers in their state. These officials tend to be more responsive to individual complaints than Washington, D.C. bureaucrats.

Ultimately, though, we believe that OFC proposals create an environment in which the state system could not survive. OFC supporters believe that this proposal would create a healthy regulatory competition that will force state regulators to cooperate and be more receptive of the role of market forces. However, when state resources are siphoned off by a new federal bureaucracy, state insurance departments could be prevented from functioning at their current capacity and the ability of state insurance departments to function and approve products in a timely manner could be diminished. Thus, companies who continue to operate under the current system might be forced to become federally chartered. Additionally, much of state insurance fees and taxes are important sources of general use revenues used for state treasuries to fund various state proposals. In 2006, state governments received almost $2.75 billion from non-premium tax revenues (e.g. fees and assessments) and $13 billion in premium taxes. Current legislative proposals would fund a new federal regulator from industry fees and assessments, so examination and other fees for federally-regulated entities will shift from state to federal coffers resulting in a significant loss of state revenue. We also believe that eventually a significant portion of state premium tax revenue will be lost to the federal government.

OFC supporters like to point to the dual banking system as an example of how regulatory competition could work, but this is an analogy that should raise many concerns. As we have seen in recent years, with the Office of the Comptroller of the Currency's (OCC) forceful assertion of preemption, federal regulatory schemes can do grave harm to state consumer protection regulations. Current OFC proposals also would create a confusing patchwork of solvency/guaranty regulation, and would not replicate the significant structural (and prudential) improvements that were made in the banking model in the aftermath of the S&L and banking bailouts. The dual structure proposed under current OFC could have disastrous implications for solvency regulation by largely bifurcating this key regulatory function from guaranty fund protection. In essence, these proposals would create an insurance version of the OCC without the integration of an FDIC into that supervisory system. Such proposals cherry-pick the features from several of these federal banking laws to come up with a model which lacks the consumer protections found in any one of them, and which ignores the problems it would create for state insurers, guaranty funds, and their citizens.

Proponents of OFC assert that a federal regulator also is important if the U.S. is to remain a global financial services leader, in that an OFC would allow insurers to compete more freely and effectively. IIABA believes that the purported decline of U.S. capital markets competitiveness for insurance companies does not stem from supposed burdensome state-based regulation, but from other U.S. competitiveness concerns such as disparate tax treatment, diverse financial reporting standards, and the costs of excessive litigation. OFC will not guarantee less restrictive regulation than that of foreign competitors (or even current state regulation).

In the end, IIABA feels that an OFC would lead to a needless federal bureaucracy and unnecessarily infringe on states' rights. Unlike GLBA which effectively empowers the states through uniform regulatory standards, an OFC fails to give any assistance except through the threat of regulatory competition. Thankfully there is another way to reform insurance regulation to the benefit of consumers, agents & brokers, and insurance companies: targeted federal legislation already proven successful through the Nonadmitted and Reinsurance Reform Act.

Conclusion

IIABA has long been a supporter of reforming the insurance marketplace. We worked closely with this Committee in support of GLBA and in early 2002, IIABA's Board took a formal policy position to support federal legislation to modernize state insurance regulation. While GLBA reaffirmed state functional regulation of insurance, some large insurers continue to push for an "optional" federal charter. State regulators and legislators, many consumer groups, independent insurance agents and brokers, some life insurance companies, and many property-casualty companies are strongly opposed to federal regulation. The state system has proven that it best protects consumers and can be modernized to work effectively and efficiently for the entire insurance marketplace with the right legislative pressure from Congress.

Targeted, federal legislation to improve the state-based system presents Members of Congress with a pragmatic, middle-ground solution that is achievable – something we can all work on together. The enactment of targeted federal legislation to address certain, clearly identified problems with state regulation is not a radical concept, as evidenced by prompt passage of the Nonadmitted and Reinsurance Reform Act by this Committee last year and the full House this summer. We encourage the House Financial Services Committee to continue to pursue targeted reform, specifically in the area of agent licensing reciprocity. It is the only approach that can bring the marketplace together to achieve reform.

NAIC News Release
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FOR IMMEDIATE RELEASE

NAIC PRESIDENT DEFENDS 'DYNAMIC, ROBUST' REGULATION

Implores Congressional Subcommittee to 'Modernize, Don't Federalize'

WASHINGTON, D.C. (Oct. 3, 2007) — National Association of Insurance Commissioners (NAIC) President and Alabama Insurance Commissioner Walter Bell testified today as to the strength and stability of state-based insurance regulation.

"Every day, state insurance departments make certain that insurers meet the reasonable expectations of American consumers with respect to financial safety and fair treatment," Bell told members of the U.S. House Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises. "In addition to successfully protecting consumers, state insurance officials have proven adept stewards of a vibrant, competitive insurance marketplace,"

Specifically, Bell outlined a number of major areas where state insurance regulators have implemented initiatives that have successfully strengthened state insurance regulatory processes, including:

- Speed to market;
- Solvency and guaranty funds;
- Consumer assistance and education;
- Fraud detection;
- Regulatory actions against companies, agents and brokers;
- Turnaround on rate and form filings;
- Producer licensing; and
- Company licensing.

"We have been the face of regulatory reform, coupling an aggressive enforcement mindset with advanced techniques to provide comfort to American consumers in times of peril," he said. "However, there are limited areas where insurance regulation could benefit from a federal presence."

For example, state insurance regulators have often requested access to FBI databases in order to conduct background checks on potential insurance agents and brokers. In addition, state insurance regulators have encouraged the enactment of federal legislation such as the Terrorist Risk Insurance Act (TRIA), which provides a federal insurance backstop in the event of a terrorist attack.

"The NAIC and its members welcome Congressional interest in insurance supervision," Bell said. "But even well intended and seemingly benign federal legislation can have a substantial adverse impact on existing state protections for insurance consumers. Modernize, don't federalize."

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About the NAIC

Headquartered in Kansas City, Missouri, the National Association of Insurance Commissioners (NAIC) is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. The NAIC's overriding objective is to assist state insurance regulators in protecting consumers and helping maintain the financial stability of the insurance industry by offering financial, actuarial, legal, computer, research, market conduct and economic expertise. Formed in 1871, the NAIC is the oldest association of state officials. For more than 135 years, state-based insurance supervision has served the needs of consumers, industry and the business of insurance at-large by ensuring hands-on, frontline protection for consumers, while providing insurers the uniform platforms and coordinated systems they need to compete effectively in an ever-changing marketplace. For more information, visit NAIC on the Web at: http://www.naic.org/press_home.htm.

National Association of Professional Insurance Agents

The Need for Insurance Regulatory Reform
October 3, 2007
Statement to the Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises of the House Financial Services Committee

Thank you for the opportunity to share the concerns of the members of the National Association of Professional Insurance Agents (PIA) regarding the regulation of insurance. PIA represents more than 10,000 Main Street independent insurance agencies, with members in all 50 states and Puerto Rico.

PIA believes that consumers are best served by an insurance system that is regulated by state Departments of Insurance. In response to the constantly changing needs of a dynamic insurance marketplace, PIA supports state efforts to simplify and modernize insurance regulation through the established state regulatory system. These efforts include the establishment of interstate compacts to streamline state-to-state regulatory activities.

This Committee's actions have historically been rooted in a belief in the state insurance oversight system, and the need for the federal government to make sure the state system is doing its job by providing the support needed by state authorities. Optional federal charter proposals run contrary to numerous Congressional actions over the years to provide this assistance, actions PIA has supported.

Insurance law is a very complex set of multi-layered state laws with some federal overlay. It is far more state-centric, active and dynamic than banking law or securities law ever has been or could be. Insurance law should not be overlooked, ignored or stepped on, as it would be under an Optional Federal Charter. To do so would open new reforms to serious legal threat and challenges, ones not likely to be won by the new reformers.

It is with a considerable amount of distress that our association has observed recent attempts to undermine state regulation of insurance by those who propose the establishment of a bifurcated, dual regulatory structure. Proposals to establish a so-called Optional Federal Charter are truly a misnomer, in that granting some participants in our industry the ability to opt for federal-only regulation would not allow them to "opt out" of all state laws and regulations.

Permitting a subset of competitors in the marketplace to evade state law artificially confers upon large, national entities that are positioned to accommodate dealing with an alternate federal regulatory scheme an unfair competitive advantage over their smaller, regional or local competitors. PIA believes that the federal government should not attempt to pick winners and losers in the insurance marketplace in this manner, by enacting legislation favoring one group of competitors over another.

Perhaps the most compelling reason that the federal government should not consider establishment of a duplicative, parallel regulatory scheme for the insurance industry is the imperative of consumer protection. Currently, many states provide a level of robust, effective

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protection for insurance consumers through state laws administered by the various Departments of Insurance. Overlaying a federal regulatory structure with what would be a much lower level of enforcement of much weaker consumer protections is not in the public interest.

Additionally, it should be noted that permitting a subset of insurance competitors to opt-out of state insurance regulation would not necessarily allow such entities to exempt themselves from state laws in a number of areas, nor should it. Creation of a bifurcated federal-state system, we believe, would lead to legal chaos prompting an upsurge in costly litigation, to the detriment of all insurance consumers.

Whether optional or not, dual or exclusive, PIA strongly opposes a federal regulator for the business of insurance for one overarching reason: one is not needed.

It is for many of these reasons outlined above that lawmakers in Colorado, Alabama, Ohio, Texas, Michigan, Rhode Island, New York and North Dakota, among other jurisdictions, either have passed or are in the process of adopting resolutions urging Congress to keep insurance oversight a state prerogative. Several organizations including the National Governors Association, the National Conference of Insurance Legislators, and the National Conference of State Legislatures and the National Association of Insurance Commissioners all oppose the creation of a federal insurance regulator. In fact, we urge you to discuss this matter with your governor, insurance commissioner and state legislators as you contemplate such a radical change in the way a significant sector of our economy is regulated.

As you consider reforms to our nation's system of insurance regulation, please be aware that, contrary to what some groups may tell you, the system is not broken and it does not need to be "fixed." It is functioning well, as evidenced by the continuing profit performance of insurance carriers and the robust financial health of the industry as a whole. Continuing modernizations to the state-based regulatory system is what is needed, as we have outlined here.

Quick Response
State departments of insurance are more knowledgeable about the specific concerns of their state and region. When urgent needs arise, a state regulator is able to respond in a more efficient manner than a federal regulator who may be subject to federal political pressures. This helps ensure that consumers, both individuals and businesses continue to have access to a robust insurance marketplace to protect them, rather than one that is mired in bureaucratic red tape and leaves them with uninsured exposures.

Consumer Protections
Additionally, nationally chartered insurers would not be subject to the many consumer protections that have developed over the years to ensure there is a balance between insurers' need for profit and solvency and consumers' right to be treated fairly. These protections have developed at the state level and often differ based upon the unique experiences of a states' insurance marketplace and the unique characteristics of America's varying regions.

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Additional Bureaucracy
Requiring an additional set of federal rules and oversight for federally chartered insurance entities would add another jurisdiction to the insureds' insurance coverage. This could result in a consumer having one form of coverage from a state-chartered, state-regulated insurer needing to be coordinated with coverage from a federally-chartered, federally regulated insurer in order to have complete coverage and protection against one disaster. Such a requirement is redundant and unnecessary. PIA continues to support state efforts to streamline, simplify, and modernize insurance regulation.

While recognizing the inherent strength of the state system when it comes to protecting consumers, industry participants, state legislators and regulators also agree that there is a need to improve the efficiency of the system. In March 2000, the nation's insurance commissioners committed to modernizing the state system by endorsing an action plan entitled "*Statement of Intent – The Future of Insurance Regulation.*" Working in their individual states and collectively through organizations such as the National Conference of Insurance Legislators and the National Association of Insurance Commissioners, we have made tremendous progress in achieving an efficient, market-oriented regulatory system for the business of insurance.

State legislators and regulators are on time and on target to accomplish changes needed to modernize the system of insurance regulation in the United States. For example, the states have organized themselves to form an Interstate Insurance Product Regulation Compact. As of today, 30 states participate in the compact. Together, these states represent half the premium volume in the United States and more states are considering joining. This compact provides the states with the ability to collectively use their expertise to develop uniform national product standards and affords a high level of protection to consumers of life insurance, annuities, disability income and long-term care insurance products. The Compact established a central point of filing for these insurance products, enhancing the speed and efficiency of regulatory decisions based on strong product standards and allowing companies to compete more effectively in the modern financial marketplace.

This is just one example of how the states are working toward a modern, efficient regulatory system that preserves the number one goal of consumer protection. Other initiatives include efforts to increase efficiency in the licensing of companies and producers, coordinating market conduct exams and addressing the regulation of alien companies.

PIA Member Testimonials
The most telling testimony is that of our PIA members. Here are a few statements from PIA members around the country who have contacted their Members of Congress over the past several months to let them know why they oppose federal regulation of insurance:

"When hurricane Wilma hit the west coast of Florida, my parents' home sustained significant damage. With the help of other family members we were able to travel down, clean up and secure the home to prevent further damage. Being the owner of an insurance agency in Maine, I was struck at how different things were in Florida compared to Maine. We sought advice and support from the local people who were familiar with the area and how things should be done. If we had needed support from an insurance regulatory body, it would again have been local with

the specific expertise needed for the area. I do not think we could get the same support from a federal regulator no matter how well meaning."
PIA Member
Corinth, ME

"As the owner of a small insurance agency in south Georgia, we are often faced with helping our customers do battle with some insurance companies whose business practices are unethical in nature. We often have to work with the State Insurance Commissioners office to reconcile these issues in favor of the consumer. The State Insurance Commissioner is very much in touch with the local issues that we face daily in servicing our clients."
PIA Member
Americus, GA

"In the past, many of my clients have felt secure knowing that the states of Minnesota and Wisconsin have addressed their problems in a clear, fast and precise nature. We have never had a problem that could not be addressed and solved by any state agency that is why as your constituent and a professional insurance agent, I want you to know that I am firmly opposed to the National Insurance Act. This legislation is bad for consumers-your constituents-and bad for the insurance agencies that serve them. I hope you will oppose this bill."
PIA Member
La Crosse, WI

"On several occasions I have helped my clients contact the State Insurance Division, or I have contacted the Division on their behalf. Because of local relationship with the State Officials it makes for easy access to assist clients. I also chair the Oregon Insurance Division Advisory Council (IDAC) meetings and represent the property and casualty insurance agents of Oregon on this council. We have insurance company representatives and consumer advocates on this council. It allows many people to bring ideas to the Insurance Division and have good dialogue with the Division. If the Optional Federal Charter became law we would not have access such as this with the appointed officials at the Federal Level, and it would not be in the citizens of Oregon's best interest."
PIA Member
Stayton, OR

Thank you for holding this series of hearings regarding the regulation of insurance. We look forward to working with Members of Congress and staff on this very important issue. Please contact our Federal Affairs staff at any time at 703-518-1364.

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EUROPEAN COMMISSION
Internal Market and Services DG

Director-General

[redacted]

Brussels, 21.09.07 3716
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ED/10.020/0007.01

Mr John W. Oxendine
NAIC Reinsurance Task Force
Chairman
Office of Commissioner of Insurance
2 Martin Luther King, Jr. Drive
Suite 704, West Tower
USA-Atlanta, Georgia 30334
United States of America

Subject: NAIC Draft Reinsurance Collateral Proposals – 7 September 2007

Dear Commissioner Oxendine,

The European Commission and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) have engaged seriously with the Reinsurance Task Force and with the NAIC more broadly over the last few years in order to try to find a mutually acceptable solution to the reinsurance collateral issue.

Under the Reinsurance Task Force's latest proposals, which were published on the 7th September, a US Reinsurer rated BBB- would be required to post no collateral under the new proposals, whereas an EU Reinsurer rated AAA, and subject to regulation in its home jurisdiction judged to be equivalent to that applied in the US, would be required to post 60% collateral. This is surprising, as it is not in line with the original charge given to the Reinsurance Task Force, which requires "approaches that account for a reinsurer's financial strength regardless of domicile – i.e. state or country" to be considered.

The European Commission and CEIOPS are extremely disappointed that the Reinsurance Task Force appears to have back-tracked on this issue over the last few months. As you well know, the treatment of credit for reinsurance in the US is a matter of great importance to the European Commission, European insurance supervisors and the European insurance industry and with the introduction of the EU Reinsurance Directive looming and Solvency II negotiations in Parliament and Council underway this issue is likely to receive a lot of attention over the coming months.

Given the international nature of reinsurance business and the importance that geographical spread and diversification of risks play in sound reinsurance risk management, the European Commission and CEIOPS strongly believe a system based on mutual recognition and equivalence is more appropriate for today's international reinsurance markets than a system based on requirements to post collateral. Article 50 of the EU Reinsurance Directive 2005/68/EC provides for the conclusion of such mutual recognition agreements with third countries. The proposal put forward by the Reinsurance Task Force is currently incompatible with such an approach as it not only tests for equivalence, but also involves the imposition of collateral requirements, which differ depending on the domicile of the reinsurer. We would therefore strongly urge the Task Force to revise this draft proposal, and in particular to remove the discriminatory elements contained within it.

If the NAIC's review of its credit for reinsurance rules does not result in the introduction of a non-discriminatory system, the European Commission will be forced to explore other routes to ensure that EU reinsurers receive a fair treatment.

Yours sincerely,

Jörgen HOLMQUIST

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Thomas STEFFEN

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