WORKING WITH STATE REGULATORS TO INCREASE INSURANCE CHOICES FOR CONSUMERS

HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTEREPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

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WORKING WITH STATE REGULATORS TO INCREASE INSURANCE CHOICES FOR CONSUMERS

Wednesday, March 31, 2004

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

The subcommittee met, pursuant to call, at 10:07 a.m., in Room 2128, Rayburn House Office Building, Hon. Richard Baker [chairman of the subcommittee] presiding.

Present: Representatives Baker, Ose, Shays, Gillmor, Bachus, Castle, Royce, Oxley (ex officio), Kelly, Shadegg, Ryun, Biggert, Miller of California, Hart, Kennedy, Tiberi, Renzi, Hensarling, Kanjorski, Sherman, Inslee, Ford, Frank (ex officio), Lucas of Kentucky, Clay, McCarthy, Baca, Emanuel and Scott. Also present were Representatives Hensarling, Maloney and Pomeroy.

Chairman BAKER. [Presiding.] I would like to call this meeting of the Capital Markets Subcommittee to order.

Today, the committee meets to hear testimony with regard to the continuing effort of the committee to provide regulatory relief for consumers and the insurance industry in providing services to consumers. As the committee has conducted now 14 meetings in the past 2 years on this subject, there really is little need for a lengthy introduction of the subject matter to committee members.

It is clear—and I think all parties affected agree—that some changes are not only in order but necessary. And the difficulty is in reaching the level of change that should be suggested to ensure market stability and additional choices for consumers.

It is very clear, at least to me, that as the regulatory structure becomes less burdensome and complicated, there are more providers of product, there is more competition in the relevant market and consumers win by paying lower prices by having many choices. Where we find the reverse structure, there are limited numbers of providers, premiums generally are higher and consumers lose.

This is a mission which all on the committee agree has to be undertaken. And we wish to go as far as we reasonably can go in providing a streamlined market structure that enables it to work effectively.

What has concerned me, to a great extent, in reviewing the financials of this sector of the financial marketplace, the industry does not enjoy a very comparable return on equity, as contrasted

with others in the financial marketplace. To some, that would seem to indicate victory in regulating the industry. I look at it slightly differently.

I know that without adequate capital and resources, you cannot provide the needed services. And our economy suffers.

Where the most competitive insurance product is not made available, that ultimately costs us all in lost opportunity. I do believe that Chairman Oxley has directed and we have worked hard to provide a list of recommended reforms which we hope the various stakeholders will find to be warranted and necessary.

Today, we will receive comment from various perspectives on the advisability of moving legislatively in this direction and to receive any recommendations or modifications that may be deemed advisable in light of the current market structure. I am appreciative for those who are here today and willing to participate and want to express my appreciation to all who have worked with the committee over the past months in coming to this hearing today.

This could well be our last hearing before the committee considers adoption of legislation.

With that, I would like to call on the ranking member, Mr. Kanjorski, for his opening statement.

Mr. KANJORSKI. Thank you, Mr. Chairman. And thank you for the opportunity to offer my thoughts about regulatory reform in the insurance industry before we hear from our distinguished witnesses.

First and foremost, I commend you for continuing to focus our committee on issues of insurance regulation. During the last 3 years, our panel has met on multiple occasions to discuss a wide variety of issues related to the insurance industry.

As a result of these proceedings, we have developed a better understanding of the insurance marketplace. We have additionally begun to form a growing consensus in the Congress about the need to improve insurance regulation in the United States.

In the attempt to advance these efforts, Mr. Chairman, you also recently developed an initial outline for achieving incremental regulatory reform in the insurance industry. This evolving proposal has already sparked considerable debate in the insurance community.

Although it merits receiving our collective attention, I suspect that we will eventually conclude that this reform plan to impose a new federal bureaucratic network over an existing state regulatory structure will produce unintended consequences. Later today, for example, one of our witnesses will detail the shortcomings of this outline, with respect to the protection of consumers and the needs of small businesses.

By inserting the federal government into insurance regulation, this plan will also almost certainly create new unfunded liabilities for our country. Additionally, I suspect that many will conclude that this initial proposal falls considerably short of achieving permanent and genuine reform in the insurance industry.

The outline under consideration today, for instance, envisions a weak federal coordinator with little enforcement authority. Calling for greater uniformity in insurance regulation, but then giving a

new federal overseer limited powers, is much like watching an old man trying to eat an apple after removing his false teeth.

Some have also suggested that the federal regulatory presence envisioned by this proposal could do more to confuse, rather than clarify, regulatory responsibilities. During our previous hearings on insurance reform, we have received extensive testimony from many witnesses advocating the creation of an optional federal charter.

Although the plan before us today does not address this important issue, the consensus for creating an optional federal charter continues to grow. Earlier this year, for instance, the National Association of Insurance and Financial Advisors decided to embrace certain federal initiatives that would work to improve the regulation of insurance, including the development of an optional federal charter.

A study released earlier this week also advanced the idea of creating an optional federal charter. The reform package under consideration today would create a system of joint regulation between the federal and state governments.

Rather than overlaying a federal bureaucracy on top of the State regulation, an optional federal charter would create a separate, streamlined regulatory system. Such dual oversight has worked generally well for the banking industry for many decades. And we should now consider applying it to the insurance industry as well.

Moreover, because of its standardized products in a nationwide marketplace, the life insurance industry, in my view, is particularly ready for the adoption of an optional federal charter.

Mr. Chairman, the devil—as we often say—is in the details. Because much of the proposed regulatory reform outline is currently conceptual, it is difficult this time to anticipate how the legislative language would actually work.

Despite my initial doubts, I want you to know that I am approaching today's hearing with an open mind because I share your goals of making insurance regulation more efficient, uniform and effective for consumers.

In closing, Mr. Chairman, we have reached a fork in the road and must decide which path to take. Ultimately, we might decide to modify and adopt this concession plan before the 108th Congress completes its work.

We might alternatively decide to create a commission to study these matters. We might also decide to begin the considerable work needed to create an optional federal chartering system in a future session.

These are important discussions for us to have and important matters for us to resolve. Thank you, Mr. Chairman.

[The prepared statement of Hon. Paul E. Kanjorski can be found on page 78 in the appendix.]

Chairman BAKER. Thank the gentleman.

Chairman Oxley?

Mr. OXLEY. Thank you, Mr. Chairman. Let me begin by thanking you and Oversight and Investigation Subcommittee Chairman Sue Kelly for holding, between the both of you, 14 hearings and roundtables over the last 3 years on the need for insurance reform.

Your hard work and commitment to increasing competition and effective oversight for insurance consumers created the foundation we are building on today.

In addition, I want to recognize one of the real leaders of our time: our first witness and president of NAIC, Ernie Csiszar. President Csiszar has served with bipartisan distinction for both Democrat and Republican governors in South Carolina. And he has worked closely with our committee in forging some central goals and concepts for improving insurance regulation.

Too often, the legislative process gets bogged down in turf protection, partisanship and political conflict avoidance. Rare is the leader who can overcome self-interest in the status quo and help create the opportunity for change to achieve a greater good.

I also want to thank New York Commissioner Greg Serio and past NAIC President Mike Pickens, who have also been of enormous assistance in working together to build a foundation for a consensus, middle-ground approach to reforming insurance regulation.

All three leaders have been steadfast advocates of retaining the strengths of State-based insurance oversight and have helped us think through alternatives to federal regulation as we forge a path towards uniformity.

And Mr. Chairman, I would also like to recognize our former colleague, Mike Kreidler, who of course is the insurance commissioner now in the State of Washington. And it is good to have you back here in Washington, Mike.

Achieving uniformity will not be easy. At the first meeting of the NAIC, the New York insurance commissioner and founder of the NAIC, George W. Miller, stated, "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; not retaliatory, but uniform."

That, Mr. Chairman, was in 1871, 6 years after the Civil War ended. And since then, the NAIC has testified before this committee and its predecessors numerous times that we are almost there, that new programs have been developed, new models agreed to. In just a few more years, we will be closer to the illusive goal of uniformity promised back 133 years ago.

As a former state legislator and member of NCOIL, I have been one of the strongest proponents for the NAIC and its efforts. As we have demonstrated through the 14 hearings in this committee over the past 3 years and the numerous hearings held previously in the old Commerce and Banking Committees, the States cannot get the job done by themselves.

The collective action barrier to getting 56 state legislatures and regulators to act in complete unison is—and will always be—insurmountable absent congressional legislation.

Representatives Kelly, Chairman Baker and other senior members of this committee and I worked together during the Gramm-Leach-Bliley legislation to establish what is now referred to as NARAB, a targeted, State-based reform proposal enacted into law that required a majority of states to adopt reciprocal or uniform licensing regulations.

NARAB has been an enormous success. And all but a handful of states have met the goal.

Agents can now become licensed and sell insurance to their customers nationwide, generally within 1 to 3 months, with greatly reduced red tap and cost. In contrast, company licensing takes a majority of the States over 6 months to review, with 17 percent of the States, according to one study, requiring more than 2 years to complete their reviews.

While the NAIC has tried to create a uniform application form and coordinated process for company licensing, without a congressional mandate, the effort suffers from incomplete participation, numerous deviations and unenforced deadlines. We can do a lot better.

The success of NARAB can be a model for bringing the States closer to fulfilling their own goals. After 3 years and 14 hearings, we need to move from oversight to building legislation.

We are just beginning this process. Chairman Baker and I have offered some goals and general concepts for reform. But these are intended to be a starting point for discussion.

We want to strongly encourage members on both sides of the aisle and our witnesses here today to fully participate and provide input in this early stage of working through a legislative approach. It will not be easy. We have a few issues, such as the role of a state-federal partnership to coordinate uniform insurance policy, that still need to be worked out.

But we have the opportunity, like President Csiszar and Commissioner Serio, to demonstrate a commitment to leadership and accomplish something meaningful and lasting for consumers. I hope that you will all join us in this effort and that we do not have to wait another 133 years.

I yield back.

[The prepared statement of Hon. Michael G. Oxley can be found on page 74 in the appendix.]

Chairman BAKER. Thank the chair for his leadership on this issue and for his continuing interest in seeing reform move forward. And the Capital Markets Subcommittee, Mr. Chairman, has actually had 14 meetings in the last couple of years. Ms. Kelly's work has been in addition to that, as well.

So the committee should be fully versed on the controversy at hand. I thank the chair for his participation.

Mr. Scott?

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

Chairman Baker, Ranking Member Kanjorski, Chairman Oxley, I thank you for holding this important hearing today regarding the effectiveness and efficiency of state insurance regulation. I also want to thank the distinguished panel of witnesses we have before us today for your testimony on this important subject.

While I have not yet seen evidence for the need to create a federal insurance regulator, I understand that efforts to streamline insurance regulation by the States have, indeed, been slow in development. However, since Chairman Oxley and Baker have announced that they are not considering an optional federal charter in the road map for insurance regulation and modernization, I am

interested in understanding what targeted areas of reform can be considered for streamlined regulation.

This committee must balance reforms between streamlined regulations for businesses with consumer protections. I believe that state insurance regulators best know how to respond to consumer complaints.

For example, in my own home state of Georgia, our insurance commissioner, John Oxendine, has helped tens of thousands of Georgia consumers address complaints about their insurance providers. These actions have resulted in over $20 million being returned to those consumers in 2003.

Consumers can call Commissioner Oxendine's Division of Consumer Services from 8:00 a.m. to 7:00 p.m., Monday through Friday. The commissioner also sends field representatives to each of Georgia's 159 counties at least once a month. I cannot imagine a national regulator being able to provide for a local connection or as much access to consumer advocates or investigators.

Today, I look forward to hearing from our panel about practical recommendations to earnestly begin streamlining insurance reform between the States.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Shays?

Mr. SHAYS. Thank you, Mr. Chairman. Thirty-second comments to say: one, very important hearing; two, I know you have done and others have done a tremendous amount of work on this issue.

I have an open mind about what needs to happen. But I will be looking at these types of issues. I want to see more competition and more choices.

I would like to see uniformity. I would like to see it easier to enter into the marketplace. And however that can be accomplished, I will be supportive.

Thank you.

Chairman BAKER. I thank the gentleman for his statement.

Mr. Lucas?

Mr. LUCAS OF KENTUCKY. Mr. Chairman, let us let the hearings begin.

Chairman BAKER. Thank the gentleman very much for his astute insight.

Ms. Kelly?

Mrs. KELLY. I want to thank Chairman Baker for holding the hearing. The hearings that the chairman mentioned, we found many strengths and many weaknesses with the current regulatory system. So it is clear that improvements of some sort need to be made.

There are advantages to the State regulatory system. There is a regulatory expertise that currently exists at the State level. And in addition to that, the States are sometimes more responsive to the needs of the local marketplace and the local consumers.

The committee has located, though, many areas that really need improvement. One is speed to market for the new products. Market conduct reviews are sometimes exhaustive and duplicative.

Price controls are well intended, but sometimes ill-advised and reduce availability in certain markets. The states are still not able

to achieve nationwide agent licensing reciprocity that we ask for in NARAB.

We are close. But we need the rest of the States into NARAB.

The insurance commissioners and companies, consumer groups, agents, brokers—we have had a lot of witnesses here. And they have all agreed that there is a need to modernize the current regulatory system.

I think we need to consider reforms to reflect the marketplace changes and allow the institutions to better serve our customers. The greater focus on improving regulation was promising when we passed Gramm-Leach-Bliley.

But the ideas have only gotten us so far. And I think the American people are in a position now where they really expect and deserve some action on our part.

It is clear that the NAIC will continue to struggle with many of the programs. Unfortunately, consumers continue to suffer because the State legislatures fail to act on the good ideas of both the NAIC and the NCOIL.

It is clear that the time has come, that we have to have some new federal legislation to help the States modernize their own insurance regulation. We need consistency. We need an ease for the people in the business to reach their customers. And we need an ease for the customers to understand what is going on.

Prior to NARAB, the States had been trying to get some kind of a reciprocity with licensing for years. And as the chairman pointed out, the insurance industry itself recommended that that happened way back in the 1870s.

So the success on NARAB is only going to come if we get all of the States in. We have to build on that model in other areas of state insurance regulation. And we have to help the NAIC get their goal of more efficient and more effective regulation.

I look forward to our witnesses today. And I commend Chairman Oxley and Subcommittee Chairman Baker for a lot of hard work and leadership on these issues.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentlelady for her statement.

Mr. Sherman?

Mr. SHERMAN. Thank you, Mr. Chairman. As an old tax commissioner, I am thrilled that we are joined today by my distinguished friend from North Dakota, Mr. Pomeroy, a former state insurance commissioner. And if his interest in insurance is such that he would like to switch committees, we will talk.

[Laughter.]

Mr. Chairman, it seems to me that there are at least four different areas that are grouped together as insurance regulation. The first is getting a product approved so that we know that that product, contract or form is in the best interest of consumers.

The second is the safety and soundness of the company, so that those who are insured know that they will be paid. And that involves both the auditing process and setting standards.

The third is dealing with consumer complaints against an individual company, dealing with how a particular consumer is being treated.

Then the fourth, as the chairman of the full committee mentioned, is professional licensing and enforcement, dealing with the individual agents and brokers. And as the chair pointed out, that is an area where we have had some success.

It appears to me that it is only in the first category that I am told that we really have problems; and that is, getting a product to market. It will be interesting to go through these hearings and see whether there are problems in other areas.

I would hope that, whether it be a federal bureaucracy or better coordination of the State bureaucracies, that we will be able to get products to market quickly so that consumers will have the maximum choice and that choice will be relevant to their needs at the time.

I yield back.

Chairman BAKER. I thank the gentleman.

Mr. Royce, did you have a statement?

Mr. ROYCE. Thank you, Mr. Chairman. I want to just take a moment and commend you and also Chairman Oxley for your leadership on this issue.

Consumers, I think, of insurance products are going to benefit from more efficient regulation. And it is clear to me that the leadership of this committee is trying to help the marketplace for the better.

But I also have a parochial perspective on this. I am very deeply troubled by the insurance regulatory environment that we have in my home state of California. And I would just like to share with you, Mr. Chairman, the homeowners' insurance market as an example.

The regulatory environment in California, in my view, would make the old socialist, East Bloc, command and control planners proud. Because we have ended up in a situation in California where we have the largest marketplace in the United States. And yet, California homeowners pay some of the highest premiums in the United States.

I think our experience has been that insurance firms are more likely to leave than to expand their businesses in California. And that is because of the price control-based regulatory regime that we have there.

And this means that a bad situation in California has the potential to get worse.

Now California has the largest economy of any state. And it is frankly one of the largest economies in the world.

And I think this committee and this Congress should be deeply concerned about the negative economic effects of California's price controls, as well as their limits on new product innovation. But there is also the global perspective on this because our Byzantine insurance regulatory policy is deterring foreign capital from entering our own markets.

Effectively, if you are an overseas firm and you are looking to do business in the United States, you are not entering one market. You are entering 50 markets. And for this reason, our trade negotiators, when they go in to trade or to negotiate to open up markets overseas, they run into resistance every time they attempt to ex-

pand markets for U.S. financial services products abroad because the response is, "Well, you have 50 markets in the United States."

So I am a strong supporter of increasing efficiency in our insurance marketplace. I think consumers will be the greatest beneficiaries. But our economy is also going to benefit as a result of that.

And the last point I would like to make is that enforcement has to go hand-in-hand with reform; otherwise, any positive legislative package will not be implemented in a number of states.

And again, I thank the chairman for his leadership. And I yield back.

Chairman BAKER. I thank the gentleman.

Mr. Emanuel, did you have a statement?

Mr. EMANUEL. I am just going to second Mr. Lucas' recommendation.

Chairman BAKER. Terrific.

Mr. Bachus? Mr. Bachus, did you have a statement, sir?

Mr. BACHUS. Yes, thank you, Mr. Chairman.

And I thank you for holding this hearing. I think this is an important legislative hearing to discuss your Baker-Oxley State-based insurance regulatory concepts, to make state insurance regulation more efficient.

These proposals go a long way to expedite a variety of insurance products to consumers and lower the cost of insurance premiums for small businesses. So I commend you and Chairman Oxley.

As you know, Chairman Baker, Walter Bell, our Alabama insurance commissioner, was appointed by Commission Csiszar. And he is one of our witnesses today. He was appointed to chair the NAIC's Speed to Market Task Force.

And the task force addresses one of the major issues that you are addressing in the Oxley-Baker reform concept; and that is product approval. They have met regularly. And I believe they are making progress toward the goal of national standards in this area.

And I for one would advocate giving them the opportunity to do this and would hope that they would continue to make substantial progress.

In addition, Mr. Chairman, I want to thank you for your commitment to try to modernize and uniform reinsurance regulation. As you know, the U.S. reinsurance industry competes on a global basis. Reinsurers are sophisticated entities. And they are disadvantaged when trying to compete on a world stage without uniform regulation across all 50 states.

I look forward to working with you on identifying areas that will allow the reinsurance community to compete more effectively on a global basis.

And lastly, I want to take the opportunity to include testimony from the National Association of Insurance and Financial Advisors for the record and would like to do that.

Chairman BAKER. Without objection.

[The following information can be found on page 177 in the appendix.]

Mr. BACHUS. Thank you.

Thank you, Mr. Chairman, again for holding the hearing. I look forward to hearing from the witnesses.

Chairman BAKER. I thank the gentleman.

Ms. McCarthy, did you have a statement?

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman. I will hand in my statement. But I do want to welcome Mr. Serio, who originally came from West Hempstead, which is in my district, and has a great deal of respect in New York.

So I appreciate you being here. And I am looking forward to your testimony.

Chairman BAKER. Thank the gentlelady.

Mr. Castle?

Mr. CASTLE. Thank you, Mr. Chairman. I have no statement. I look forward to hearing the witnesses.

Chairman BAKER. Thank you, sir.

Mr. Inslee?

Mr. INSLEE. Just want to welcome our friend, Mike Kreidler, who has become even wiser after leaving Congress.

[Laughter.]

Chairman BAKER. Ms. Biggert, did you have a statement this morning?

Mrs. BIGGERT. Yes, thank you, Chairman Baker. And thank you for holding this series of hearings on insurance regulation. I think the thoughtful and deliberate hearings that are being held by the subcommittee will more than adequately prepare us for any future course of action that we will be taking.

I did want to thank one of my colleagues from Illinois, Dr. Phil O'Connor, for coming to testify today. He served as our Illinois insurance commissioner for 3 years and for another two as its research director.

He has a wealth of experience in this and many other policy fields. And we did work together on several commissions while I served in the Illinois General Assembly. So I am delighted that he is here.

I do want to take a moment to point out this morning that I believe the open market system for insurance in my home state of Illinois is an example of a system that works well—not just for regulators, not just for insurers, but most importantly, for the consumer.

I understand concerns that some of my colleagues may have about a change from a prior approval to an open market system. But let's look at what this system has produced. Illinois has a very small residual market and significantly more auto and homeowners insurers competing for business than states with stringent price regulation.

Illinois attracts the largest share of operating property and casualty companies of any state in the nation. And that is good for consumers.

The premiums and loss ratios in Illinois are well below most other states with large populations, high traffic density and urban concentrations. With no rate controls, regulatory resources have been freed up in Illinois, allowing state regulators to initiate other innovative safeguards, such as early warning systems and computerized market conduct exams.

An open market system does not mean a wild or unfettered system; quite the contrary. The Illinois Department of Insurance has

oversight authority and is required to monitor the marketplace and report to the General Assembly.

The department plays an important role. But it does not determine rates. Rates are driven by economic demands, not politics.

There are numerous stringent consumer protections in place as well. The benefits of an open market system have been recognized by consumers in Illinois for 30 years, which is why no one has ever tried to change the rate system.

Some of my colleagues may believe that price controls magically lower prices below competitive market levels, while at the same time stimulate an adequate supply of coverage. To me, this is just a myth.

We have seen the reality of price controls in markets like those in New Jersey. A large number of insurers pulled out of New Jersey entirely, citing the unique burdens posed by the State's auto insurance regulatory system.

A regulatory system that drives insurers out of the market is not an ideal regulatory system. An open market system like that in Illinois, in my view, is closer to the ideal.

So putting all parochial interests and personal bias aside, I can objectively state that Illinois has one—if not the most—efficient systems in the country. Illinois has delivered more choice, better prices and a stable market to consumers.

So the open market competition works in Illinois and has worked very well for 30 years. My hope is that Illinois can serve as a model for other states that want to serve consumers better.

I look forward to the testimony of Dr. O'Connor.

And thank you, Mr. Chairman. Yield back.

Chairman BAKER. I thank the gentlelady for her statement.

The committee has the pleasure today of having two ringers. On the Democrat side, we have the former insurance commissioner, obviously knowledgeable in matters of insurance and is expressing today his deep interest in the subject by attending our hearing.

Welcome, Mr. Pomeroy. Would you care to make an opening statement?

Mr. POMEROY. Mr. Chairman, thank you for allowing me to attend. I look forward to hearing from the witnesses and I will have some thoughts on this matter that I would like to share with the committee at a later time.

But I commend you and Chairman Oxley and Ranking Member Kanjorski for advancing this issue in a very thoughtful and substantive way. I remember being on the witness side of the table in the room when I thought the topic of federal regulation was being advanced in a less thoughtful way. I appreciate the way this issue is proceeding, and I thank you for allowing me to participate.

Chairman BAKER. I thank the gentleman for his interest and participation.

And on the Republican side, we have a member of Financial Services, but not on this subcommittee. We welcome the gentleman from Texas, Mr. Hensarling. Would you care to make an opening statement, sir?

Mr. HENSARLING. Yes, thank you, Mr. Chairman. And thank you for allowing me to attend.

The title of this hearing is "Increasing Insurance Choices for Consumers." As a former student of economics and a small businessman, I understand that when we are talking about increasing choices for consumers, we must of course discuss decreasing the regulatory burden on businesses.

The best and most effective consumer protection will always be a competitive marketplace. And I believe this committee and Congress can play an important role in ensuring that American consumers have access to the most affordable and most varied insurance products available.

Now I do not trust any single company to make their products affordable and varied. And I do not trust any particular industry to make their products affordable and varied.

I do, however, trust competition in the marketplace to do just that. One only has to look at history to show the possibilities that exist by stripping away excess regulation.

When Congress decided to deregulate the airline industry in 1978, the number of cities served by more than one airline increased by 55 percent. And service was extended to more than 140 additional airports. The impact on airline travelers was estimated at $11 billion in savings.

When Congress deregulated the trucking industry in 1980, the number of carriers doubled, while rates for small shipments decreased by approximately 25 percent.

From airlines to trucking to natural gas—and the list goes on—history has shown us that deregulation can bring down real prices—by 25, 30, even 40 percent over time. Thus, history also shows us, in order to get to a point of effective competition in the insurance industry, we must carefully examine what has been inhibiting choice and driving up costs for consumers.

I believe the most important factors have been the price controls and the large, expensive regulatory burden imposed on the insurance industry by many state governments. The sooner we can move to a more competitive market-based system, where financially sound companies have low barriers of entry and are free to compete with minimal interference, the better off consumers will be.

I happen to be a homeowner from Texas, the State that the Census Bureau deemed in their last survey to have the highest average premium for homeowner's insurance in the nation. Thus, I understand the negative impact price controls can have on competition and how this can ultimately adversely affect the consumer.

My constituents in Texas are paying, on average, more than double for their homeowner's insurance than what consumers pay in states with limited or no price controls. And they frequently contact me and ask me to help do something to help them find more options for cheaper insurance products.

Recent studies have shown that consumers living in states with minimal or no price controls pay significantly less for most types of insurance than do consumers residing in states with significant price controls.

I look forward to working with you, Chairman Baker and Chairman Oxley, to address the problems that price controls and other government-imposed regulations have had on the insurance indus-

try and the availability of affordable insurance products for consumers.

I thank the chairman and yield back.

Chairman BAKER. I thank the gentleman for his statement and for his interest in the matter and giving his time today to the committee.

Is there any member wishing a further opening statement?

If not, Mr. Kanjorski wishes recognition for a unanimous consent. Mr. Kanjorski?

Mr. KANJORSKI. Mr. Chairman, it seems like insurance—or former insurance—commissioners are falling out of the woodwork. But I would like to offer for the record a statement from the former state insurance commissioner of Nebraska and now the outstanding Senator from Nebraska, Ben Nelson, for purposes of insertion into the record.

[The following information can be found on page 187 in the appendix.]

Chairman BAKER. Without objection, so ordered.

I thank the gentleman.

At this time, we would wish to proceed to our distinguished panel of witnesses. I have a deep appreciation for the difficulty of the task each of you have undertaken and want to express my true appreciation for the level of work and effort committed to trying to resolve the concerns that many have outlined this morning in their opening statement.

I do believe we have made significant progress. I believe we are on the verge of adopting legislation, which all stakeholders can view as being very constructive and moving in an appropriate direction for the consumers we all serve.

Director Csiszar from the South Carolina Department of Insurance has been steadfast and continued in his leadership. I have great regard for your work.

I also want to welcome the other two gentlemen to the table this morning. Before I proceed though, I think Ms. Kelly from New York has a word she would like to offer at this time.

Ms. Kelly?

Mrs. KELLY. My word to offer is that it is a great pleasure to have Greg Serio back with us. He is the superintendent of insurance from the great State of New York.

Greg was confirmed as New York's 39th superintendent back on May 9, 2001. He served 6 years prior to that as first deputy superintendent and general counsel of the department for 3 years.

In addition to being a very well respected member of the NAIC where he serves in a leadership capacity, Superintendent Serio is a good friend. And we feel he is a great asset for the State of New York.

It is a pleasure to see you here today, sir. And I look forward to hearing from you.

Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Ms. Kelly.

And also to introduce to the committee formally Mr. Mike Kreidler, from Washington State, who is also a former member. I wish to extend our welcome to you today, sir.

Today, Mr. Csiszar appears not in his capacity as the director of insurance of South Carolina, but in his capacity as spokesperson for the National Association of Insurance Commissioners. Please proceed at your leisure. Your formal statement will be made part of the record.

STATEMENT OF ERNST CSISZAR, DIRECTOR, SOUTH CAROLINA DEPARTMENT OF INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. CSISZAR. Thank you, Mr. Chairman. It is indeed a pleasure for me and my colleagues—Mike and Greg—to appear before you this morning.

And I can without any hesitation begin this statement by affirming to you that not only are we desirous to become partners in this process, to offer our expertise to the committee in this process. We are eager to do so.

We are eager to participate as we move forward from what you have generously shared with us, this conceptual framework that we currently have in front of us, and moving from that conceptual framework to a more detailed legislative kind of agenda.

So I want to restate and reaffirm the fact that we are also of an open mind. We have a good deal of expertise that I think—all of us and the committee members in particular, we offer it to them—that will help in this process.

We are by nature problem solvers when we deal with our constituents. And we know we have some problems in this regulatory system. And we know, as commissioners, as much as you as members of the committee realize, that reform is needed.

We are of course particularly pleased that the framework for this reform is not a dual charter of an optional or non-optional type. We are pleased to see that this is the so-called "federal tools" approach.

And while we are really in no position to comment on the details, because it is all conceptual at this point, as I said, we are very eager to be at the table and to work with you in developing these concepts, flushing out these concepts into what will eventually, presumably, be legislation.

I think the spotlight that this committee, through its hearings, has brought to the issue has been good. I think it has instilled a sense of urgency amongst commissioners, as well as amongst others who have an interest in this, such as our legislatures and our governors.

And I think we welcome just that very process. The congressional oversight, I think, is always welcome. And we are eager, as I said, to continue with this process.

Now let me just review very briefly—I know some of you have heard many of these things before—but let me just reaffirm and review briefly what is in progress at the NAIC and why we think that a State-based system of regulation is, indeed, better than any other form of regulation if the State-based regulation can indeed be reformed with the vision, with the concepts that we have in front of us.

We have not been, as you know, standing still in the years since Gramm-Leach-Bliley. On the speed to market, which Mr. Bachus so

kindly mentioned, yes, Walter Bell is indeed in charge. We have a very aggressive agenda.

We have the interstate compact. It is three different issues really: the interstate compact and the implementation of that compact in the States; the development and implementation of standards for the product to go through that compact as the single point of entry; and then of course our electronic filing system, which is an integral part of this as well.

Let me just briefly give you some updated numbers. As you know, the interstate compact has been endorsed both by NCOIL, the National Conference of Insurance Legislators, as well as by NCSL, the Conference of State Legislators.

Roughly 20 jurisdictions are looking at introducing that compact in their legislative sessions. Two of them have actually passed it—Colorado and Utah. I understand there are two more—Virginia and West Virginia—where the legislation is sitting on the governor's desk, but has not been signed yet.

We are aggressively pursuing the introduction of that compact this year and in the year to come. Very personally, I can tell you in South Carolina, we are going to be introducing that compact in the coming legislative session.

As regards standards, this is again key. The compact is nothing but a skeleton unless you have those standards that apply to the particular products.

We have identified 24 different product categories. These 24 product categories are working their way through this group headed by Walter Bell. Our timetable is that by our December meeting this year—which will be in wonderful Louisiana, in New Orleans—by New Orleans, we are going to have those standards in place.

They will, in essence, flush out the interstate compact. And between the two, there you have your single point of entry. There you have your uniformity and, as I said, aggressively pursue that compact for adoption.

On SERFF, by the way, I can only report that our filings have tripled this year. In fact, in 2004, we expect somewhere around 140,000 to 150,000 filings to come through that electronic system.

The average turnaround date on those, by the way, is 17 days. So I think we have made very, very good progress. And I can assure you, we will continue to make good progress by year end.

As regards company approval, we have our alert system. We are continuing to work on making that system more user-friendly and developing a more uniform approach to certificates of authority. And I think we have made good progress.

And again, by year-end, I expect to report back to you that we are in good shape on company approval.

On the NARAB issues, here actually you have a clear example where the licensing of agents and brokers is an area where there is in fact some federal help needed. Here is a case where a good many of the difficulties we have had in moving from reciprocity or even inter-reciprocity and from reciprocity to uniformity, where a good deal of the difficulty has arisen because of our inability to tap into the FBI database.

Here is clearly a case where Congress, I think, can help us overcome that. And we will be, I can assure you, in step with you in making progress towards uniformity in this area.

On market conduct, we have most recently proceeded to implement a handbook that is now a standard procedure for market conduct. That has always been one of the problems that different states did things different procedurally, not just substantively.

We are implementing an analysis process. This analysis process will be uniform. We are collaborating between states.

While there is no resolution to this issue, we are actively looking at how the new NCOIL model in market conduct overlaps with our work and to what extent we can make ourselves run in parallel with the NCOIL mode. That is currently under consideration. I cannot report to you a final result yet. But I can assure you, again, that we are making progress in this area.

On the financial side, we realize that on the financial side, which is the crown jewel of what we do, the solvency issues, we know that reform is needed there. We know that we can update, for instance, our risk-based capital figure. We know that we need to move from the traditional post-review, looking back for 3 or 4 or 5 years to a forecasting approach, to a risk-assessment approach, if you will.

Kevin McCarthy, who is the commissioner in Florida, he and Tom Gallagher are chairing that group. And we are very, very actively making good progress in that area, even on the rating issue, the personal lines rating issue, which is clearly the most contentious issue, I think.

This whole notion of where competition fits in all of this, even here I can report to you that 36 states actually have competitive rating models in place. Fifteen states, however, have a very strict prior approval process.

But that is a contentious issue, has been a contentious issue for the last 100 years and continues to be one today. And it is good to keep in mind that on those issues, Mr. Chairman, we also, regardless of what we as commissioners may think, we also have other constituents to deal with, ranging anywhere from our legislature to our governor to the attorneys general. And in some states, the trial bar has also actively become involved on issues of that kind.

I might also point out that even though we realize that significant reforms are needed, the system has actually worked fairly well. I think it is interesting to note that we have not had the same kinds of problems that we have seen with Tyco and Enron and the others, where directors, auditors, bankers, executives have compromised themselves really through self-dealing, sometimes to the point of criminal activity.

We have not seen that kind of activity in the insurance industry. And I think in many ways state regulation, because it is closer to the market, it is closer to the consumer, to some extent, at least, I think we can attribute that result to the effectiveness of state regulation.

So in summary, rather than going into details, I will leave it open to questions, but in summary, we are with you. We want to be at the table. We will help you. We offer our expertise to you.

Please take advantage of it. And we will walk step in step with you as we make progress in this entire process, in this entire federal tools approach.

So that is where we stand. Mike and Greg, I think, want to make some brief comments. And I will stop with that.

[The prepared statement of Ernst Csiszar can be found on page 100 in the appendix.]

Chairman BAKER. Please proceed as you choose.

STATEMENT OF MIKE KREIDLER, WASHINGTON STATE INSURANCE COMMISSIONER

Mr. KREIDLER. Thank you, Mr. Chairman. I come in part here because I think I reflect the diversity of what we see in membership of the NAIC. I think it represents the diversity that you have in the Congress, you will also find diversity among the commissioners across this country of ours.

As I look at it, I come from a slightly different perspective. I come from a perspective of not being somebody that has spent their life working in the insurance industry or as a regulator.

And I think I can stand back and look at it from much the same perspective of many of the members who had the opportunity to serve in their state legislatures and view what took place in insurance regulation and the role that states play and then also to take a look at it from the perspective of the problems and challenges that we face.

No one is saying that there are not problems and changes that are necessary and we agree that there are places where the Congress can effectively assist as we go forward in making changes in the system. I would however point out that there are areas where the need is more acute, from the standpoint of the nature of the products then in other areas. The areas that have been identified by the committee certainly are very much recognized by members of the National Association of Insurance Commissioners, are in life insurance products. These very much are products that need a standardization and a uniformity.

I am proud of the success that we have shown and are exhibiting in the area of an interstate compact. We also have three states currently that are in the process of beginning the process of accepting applications through a memorandum of understanding. And they are three of the largest states that we have.

I would believe that we will wind up having one uniform system for those particular types of products. And we are moving aggressively in that direction.

I would commend the committee for helping to put pressure, so to speak, on the insurance regulators to recognize that these changes are necessary and needed. There are always going to be forces that would like to go slower rather than faster, that change sometimes comes hard.

But the pressure that we feel and the changes that we are bringing about are ones that are very consistent with what you have heard before this committee and what we feel as insurance regulators.

One area where I am particularly concerned as we approach this tools list of various items is: where do the consumers fit into this

equation? I really do believe that the issues related to consumer protection are of an acute nature.

Let me give you some idea. We had over 200,000 contacts with my office in the last year from consumers. We have over 700 cases that we are currently working with consumers.

This is an issue where you have a promise by insurance companies to fulfill an obligation that is very different from that of financial services associated with banking. They are changes that need to be approached cautiously.

When we get into some of these areas that we have before us right now in the area of property and casualty, for example, whether it is homeowner's insurance of automobile insurance, there is a great deal of difference between the States—whether it be their tort laws or whether it be because of the kind of urban versus rural distribution; whether it be because of any number of factors that cause the rates to be very different from one locale to another.

In the area of commercial forms in commercial insurance, I think there are some changes that you could help us with. One of the challenges that we face right now is getting some of the agents that are independent agents in the State of Washington comfortable with deregulation. For example, striking a balance of their needs with the larger agents and brokers and the companies, is being able to strike that bargain as to where does the consumer need protection? And where does an unregulated market take effect?

States would like to go further, but frequently run into resistance because there is a bit of a provincialism here of trying to keep that standard too high. I think that is one place where you could essentially further help us to address that problem by pushing on that issue. But again, do not push it too low.

If you are a business that does not have a professional risk manager on staff, you are not going to be in a position to go into a market that is unregulated and be able to make the sophisticated choices. You are much more like the homeowner or the automobile insurer that is going to be concerned about what your product has and you do not have the sophistication to make a determination. So that threshold of deregulation is important to us.

When it comes to the issues related to agent licensing, Commissioner Csiszar pointed it out. One of the problems that we face there when it comes to agent licensing is that there has been resistance here at the national level to do what we have done in the State of Washington for years, which is to give the insurance regulator the authority to take a look at the FBI database.

In fact, our independent agents aggressively supported to make sure, when the FBI came through and we questioned whether we had direct statutory authority in the State of Washington to access that database, they actively supported us doing so. I can tell you right now that there are out-of-state licenses that have been requested in the State of Washington where you have individuals with felony convictions in the financial services area that are agents in good standing in some states and we quite frankly would not like to see them doing business in our state.

You could help us by making sure that all states have that kind of access and are doing that kind of FBI fingerprint check on every individual who does business in their state.

These are some places where you can assist us in doing those changes. I would urge caution in the breadth of what is outlined right now in the tools, in no small part because of its impact on consumer protection.

What may be good for the companies may not be good for the consumers. And consumers need a seat at this table that is very strong and making sure that their rights are adequately protected.

Thank you, Mr. Chairman.

Chairman BAKER. Thank you very much.

Superintendent Serio?

STATEMENT OF GREGORY SERIO, SUPERINTENDENT, NEW YORK STATE INSURANCE DEPARTMENT

Mr. SERIO. Good morning, Mr. Chairman. And thank you for having us again.

Mr. Kanjorski—and thank you to Ms. Kelly and Ms. McCarthy for the kind introductions earlier.

Let me take a perspective that one of your members took a few minutes ago and amplify that just for a minute; and that is on: what is the end goal of the modernization? We want competition in the marketplace. And I think we share that with you.

We want consumer protection, as Commissioner Kreidler indicated. We want that. And I think we all share that issue as well.

Just to give you a context that this is the right thing to be working on and focusing on, in terms of modernization of the insurance regulatory system, the activities that we have already undertaken, both in partnership with the Congress, as well as individually through the NAIC, have yielded those kinds of consumer protections that we are all benefiting from right now. And this is a context. And this is an objective that I think we are trying to keep in mind as we go forward, working with you, on the concepts of the design and on the design of the details of your conceptual draft.

And that is that in New York and in other states, we have been able to retask a lot of our insurance resources—scarce state resources. And everybody knows the difficulties the States are having with respect to their budgets.

But by taking on the modernization initiative, largely at the impetus of the House Financial Services Committee in the Gramm-Leach-Bliley bill a few years ago, and then taking on that with the Statement of intent with the NAIC an the restatement that we issued last year, we have been able to make firm inroads into added consumer protections by retasking.

A lot of our human resources at the department, our staffs that used to open up envelopes, handle paper, take phone calls, as opposed to the types of modernizations that we have been able to do, leveraging technology, leveraging uniformity between the States and really making it a more efficient system, we have been able to retask those resources into added consumer service representatives, into added frauds investigators, into added and real-time financial surveillance.

There is an end result here that I think sometimes we miss as we talk about the details and getting through the devils of the details and things of that nature; and that is that is a laudable objective that we subscribe to entirely. Because we, as the managers of

the 51 or 54 state regulatory insurance agencies and in the District of Columbia and in Puerto Rico and the Virgin Islands, we know the need to retask and reuse and retool our existing agencies to make them better at what we are asked to do—and that is, protect the consumers and do better in the job of financial surveillance, real-time, market monitoring to make sure that those things that have been filed are being used the way they are supposed to be in the marketplace.

This is one of the things we have already found by the activities we have undertaken at the NAIC, by the uniformity and the reciprocity that NARAB really pushed us to do. And I am very pleased and probably would not have been asked to come if New York had not passed a producer licensing bill, as we did last year. That is having real tangible benefits.

So as we go forward, and as we create the balance between what is good for the companies, good for the consumers, let's realize at the end of the day that this is also good for the efficacy of the regulatory process because it is allowing us to put our resources where they need to be the most, in terms of protecting those consumers.

Thank you.

Chairman BAKER. Thank you very much.

Commissioner Csiszar, as Superintendent Serio was just outlining in his New York case, where the transition from prior regulatory structure to a more streamlined structure had a couple of benefits to his constituency. Viewing the South Carolina experience, having gone through the regulatory modifications from your view, it appears that there are two different distinguishable changes that have occurred. And I would like you to speak to those.

On the one hand, it seems as though more product is now available for consumers and that the competitive market results in better pricing opportunities for consumers, which is the direct goal we hope would occur. But along the line of limited state resources, it would seem that getting your staff out of a stricter regulatory oversight posture with regard to, say, product approvals and shifting those individuals over to enforcement is the real secondary benefit because it enables you to do the real consumer protection advocacy that you might have had more limited resources in the prior model.

Are either or both of those observations accurate?

Mr. CSISZAR. Well, let me speak first of all as the commissioner of South Carolina in responding to that. Clearly, in South Carolina, we reached the realization that our market is not the same as the California market, for instance.

Companies do not trip over themselves to write in South Carolina; not least because we are a rounding error on an income statement or a balance sheet. So we realized that we had to do something different if we wanted to make our market more attractive.

And the route we chose, the route the legislature chose—it was not me. The legislature chose the route of, in essence, moving from a prior approval to what is nothing more than a rate man system on the automobile side. And we are trying to replicate that on the homeowner's side this year by actually going through a transition from rate man's into a file and use or use and file system.

Now having said that, a California market may very well be different because if you are a company—a large company in par-

ticular—you probably cannot afford not to do business in California, just because of the size of the market. But certainly, what we have seen in South Carolina as the primary benefit is availability, affordability impact—clear availability and affordability impact.

And the second issue, I think again, to some extent, this is driven by Gramm-Leach-Bliley. But to some extent it is also, I think, the realization that when you look at what is it that is essential about the insurance product?

And yes, while there are many things that can be expected from the purchase of the product, the most fundamental thing to be expected is the payment of the claim when a claim comes due. And that claim may come due tomorrow or the day after the purchase or it may come due 25 years from now.

So when you look at fundamentally what is it you have to do to protect the consumer from the standpoint of the company being there when that claim needs to be paid? Solvency, of course, immediately comes to mind.

So we have managed in South Carolina to focus much more on solvency, number one, and at the same time also dealing with consumer complaints. Because as my colleague from Washington stated, we too in a small state like South Carolina, we had 50,000 either inquiries or complaints; 50,000 over the phone.

And that does not count emails. And it does not count mail.

And by the way, each one of those does get answered. They do not disappear into the cracks.

So it has allowed us to really focus on those two areas. And that has been the benefit in an environment—a state environment—where yes, the budget dollars are scarce these days.

Chairman BAKER. My time is just about expired. But I want to do one follow up. Advocates of optional federal charter rightfully claim that by establishing an alternative federal mechanism for the marketing and sale of insurance product, you have the absolute assurance that you can operate in all states in a similar fashion.

One of the problems in an incremental approach comes on the enforcement side. If you look at the fair degree of success of NARAB, there are still elements that have not yet come into compliance some years after its adoption.

So it gets us to the question of if we are to seriously consider incremental, the appropriateness of some federal enforcement ability to ensure that states participate in a time certain. Is that, given the argument between optional federal charter and incremental, incremental with weaponry maybe, doesn't that seem to make some sense?

If we are really going to move the ball forward in a fixed period of time, to enable legislatures to act, to enable commissioners to conduct their review professionally, you cannot have it immediately. But after some period of time, if states have not adopted what generally all parties have agreed to as an appropriate method of conducting business, do we not have to have some enforcement ability in whatever we do?

Mr. CSISZAR. Let me start by saying that from my standpoint, Mr. Chairman, the dual optional charter is the worst of all possible solutions, really. I would rather at that point say, "Let the States

get out of this business and have the federal government take the whole thing."

You have all kinds of complications, from premium taxes to guarantee funds to so on. To me, the dual optional charter really is not the solution.

Forget about bureaucracies now and costs and so on, just from a purely business standpoint. I think I am not an advocate of that approach at all.

Having said that, yes clearly I think you have to make sure that states take this seriously and enforce it. And I can only speak again from my state on this one. I know when Congress speaks in our state or when our congressional delegation speaks, state legislatures listen and the governor listens and the attorney general listens.

So I think the very, very fact that you are engaging in this process and maybe producing a piece of legislation will speak louder than anything.

Chairman BAKER. I thank you. I appreciate your attorney general. I wish I could get another attorney general to listen, but that is another subject.

Mr. Kanjorski?

Mr. KANJORSKI. Thank you, Mr. Chairman. Following along on that question, Mr. Csiszar, is there any reason why, taking just life insurance, that it is not uniform across the country? Is there something distinctive about the people of South Carolina that they are different from California?

Mr. CSISZAR. Quite frankly, Mr. Kanjorski, I think the greatest case, the best case for uniformity can be made by looking at life products.

Mr. KANJORSKI. Okay.

Mr. CSISZAR. There is no question about it.

Mr. KANJORSKI. Well, let's follow that along. I do not have the numbers, but you probably could tell me. What portion of the insurance business written in South Carolina—or nationally, if you know—is represented in the life business?

Mr. CSISZAR. I cannot give you the figure on a national level. But I know in South Carolina, it would be significant, probably equal though with property and casualty, about 50-50 or 60-40.

Mr. KANJORSKI. Well, it would seem to me that life experience in life insurance is not too dissimilar in all the States. And listening to some of the comments of my colleague before—and yours—that really you are interested in protection of the consumer in the difficult areas.

I do not imagine that there are an awful lot of people that are calling an insurance commissioner about their life insurance policy. Or am I mistaken about that?

Mr. CSISZAR. I disagree there. I mean, for instance, we have had significant cases of churning, for instance, in the life industry. We have essentially market conduct-related types of cases.

I would say the volume on the life side is probably no different than the volume on the property and casualty side.

Mr. KANJORSKI. Okay. That is very interesting. And that is a good observation that I was not aware.

What would you say if the Congress does nothing or if we pass the proposed conceptual proposal, that we do not quite know how it will work yet? If we just do that, when would you think that life insurance would be uniform throughout the 50 states? How fast do you think we are going to get there?

Mr. CSISZAR. Well, I think this is where clearly we are taking the view that we can deliver on that issue. We can deliver. And that we can deliver before 2008 on that.

Mr. KANJORSKI. Am I to understand then that it is your testimony that by 2008, regardless of where you live in the United States, you would be able to get a uniform policy of life insurance?

Mr. CSISZAR. I think between the pressure that you are exerting on us and the effort that we are making to implement the interstate compact and the national standards, under that compact I think we can get it done.

Mr. KANJORSKI. How do we resolve this question of a global market when we have our trade representative meeting around the world and he is representing 50 sovereign entities with most of them clearly smaller than most of the other nations in the world he is dealing with? How does it get some uniformity there in terms of the impact our trade representative can have on globalization?

Mr. CSISZAR. The answer I would have there is really a question, Mr. Kanjorski. I will be interested to see how the expanded European Union is going to treat that very same question because they are the ones who have been making this argument for uniformity in the 50 states.

With the expansion of the union later on this year, they are going to have the similar situation. In fact, our trade representatives will be empowered to ask them that same question.

Mr. KANJORSKI. Well, I am just wondering why? I am not a person that is anxious to get to federal regulation of anything. But it would seem to me, from some of the past testimony that we have heard from particularly the life insurance companies, that there is sort of uniform agreement that there is nothing peculiar about this industry that is not national in scope and subject to a national standard and subject to national uniformity.

If that is the case and as we are moving along this regulatory process, if we singled out the life insurance business and offered an optional federal charter there, why would that not have a positive impact for the various state commissioners, to have more resources to regulate the difficulties that they may have in the other categories of insurance that are more parochially related to the jurisdiction they have control over?

Mr. CSISZAR. I think I go back, first of all, to my earlier comment that you do have the same kinds of problems—consumer issues, for instance—on the life side that will still require treatment at a local level, number one. Number two, I think even though you speak of it as a uniform kind of industry and perhaps the dual charter in response to that uniformity, my response to that, Mr. Kanjorski, is that we can deliver at the State level. And the expertise currently is at the State level.

If we can come back to you and say we have implemented the interstate compact. We have these standards across the 24 product categories—by the way, those are life product categories that we

are speaking of, life products and long-term care products—if we can deliver on those, then there is the solution to the uniformity issue.

Mr. KANJORSKI. Would you feel your association and the majority of the commissioners would be adamantly opposed to a national life optional charter?

Mr. CSISZAR. Very much so. Very much so.

Mr. KANJORSKI. Based on the fact that you are losing some of your jurisdiction? Or it is just the wrong thing to do?

Mr. CSISZAR. Look, I for one, this is the first time I am in public service. I come out of the private sector. I do not have a turf issue.

As I tell people, whether I work in this job or not, my dogs will get fed when I get home at night, you know? So it is not a turf issue.

Mr. KANJORSKI. You are lucky to have dogs.

Mr. CSISZAR. But to me, it really is an issue of where can the best job be done? I have often maintained publicly that the issues we are discussing, we really should not be discussing state versus federal here? We really should be discussing regulation that is outmoded and requires reform and that improved regulation that comes from that reform.

I have called it good regulation versus bad regulation.

Mr. KANJORSKI. The other thing—and I will just take one more—the only observation I want to make is that I heard the chairman of the committee mention those promising words made 133 years ago. And it seems at this point that we are always 3 to 5 or 10 years down the road.

We are already 5 years from H.R. 10. So it has been a long time in coming. And I probably personally now am starting to lose my confidence that the 50 states—all 50 of them—are capable of coming together and resolving some of these problems.

I wish they would. I wish they had already. But I am not terribly optimistic anymore.

Mr. OSE. [Presiding.] The gentleman from Connecticut?

Mr. SHAYS. Thank you, Mr. Chairman. I would like you gentlemen to outline to me the most serious challenges you think face consumers today because we do not have uniformity.

Mr. CSISZAR. I apologize, Mr. Shays. I only heard part of the question.

Mr. SHAYS. The question was this: I want you to outline to me where the consumer suffers today because we do not have uniformity and we do not have speed to market and so on.

Mr. CSISZAR. I am not sure that suffering is really the right word because when you look at uniformity, the part of the industry that seems to have the greatest need for uniformity really is on the life side. And there seems to be a plethora of products out there on the life side.

Now that is not to say that you cannot find new products and more innovative products and release them into the market quicker, if we speed to market. But we certainly do not see any sign of suffering on the consumer's part.

And that is the side that is driving the uniformity issue. On the property and casualty side, certainly we have availability and affordability issues, as we heard in California for instance, on home-

owner's. But uniformity is really more a life issue than a property and casualty issue.

Mr. SHAYS. I served in the State House for 13 years and I understand why we wanted state regulation of banks. I understand why we wanted state regulation of insurance.

Tell me why the arguments for banking, why insurance would be different than banking? Because state regulation of banking turned out to be a total and complete disaster in New England.

Mr. CSISZAR. I think the nature of the product makes this very different. What we have is, in many ways, insurance is a mandated product. It is treated as a nuisance purchase by consumers. They really do not want it, but they get it because they have to.

They have to because either the law requires it or their mortgage company requires the purchase of the product. When they purchase the product, it is not like they are opening up a bank account or getting a loan in order to buy something desirable like an automobile or a home.

What they are really hoping for is, when they buy the product, is that they never have to use that product. And really, what they are getting from the insurance company, even though it is this 40-page piece of paper, what they are really getting is nothing more than a promise.

And here the issue is then what can the process or what kind of regulatory process can you bring to the table that assures that promise will be fulfilled, as indeed promised? So I think it really is a different kind of product from a banking product. The nature of the purchase, the nature of the buyer's expectations are very different here from a typical banking product.

Mr. SHAYS. I wrestle with this bottom line. And what I wrestle with is that I want consumers to get the latest products as quickly as possible. And I want there to be as much competition as there possibly can be.

And I am struck by the fact that that is not the case under our current system. Why do you think this legislation would resolve that?

Mr. CSISZAR. I think certainly the pressure that you are exerting through this legislation and the fact that we are at work on an interstate compact—well, we have the interstate compact; we need to implement it—the fact that we are working on those standards of uniformity, the fact that we are turning things around through our SERFF system in 17 days and not 2 years, the fact that that message is getting through to the larger states. As Mike said, for instance, we have an MOU now between Texas and California and Florida on some of the life products. That very fact, I think, is going to change things.

Secondly, if you look at new products and introducing new products, again I go back to the fact that I think the State-based system is much preferable to a federal system because it allows you to experiment without betting the ranch. If you have a new product and an innovative product, you can test that product in a state and see how it works.

Mr. SHAYS. I do not understand the last point. I mean, you could test a product whether or not you had national or not.

Mr. CSISZAR. That is true. But on the other hand, the State-based system allows some flexibility in terms of only introducing it in that state, if it is permissible in that state, and testing it in that state.

No, I understand what you are saying. You are saying you could take and introduce the product anywhere. That is true.

But I really think that there is a flexibility in that State-based system, much as what we have seen with our welfare system, where the "one size fits all" does not always fit, where a state has to be allowed to, in essence, do its own thing.

Mr. SHAYS. I thank you. And I likewise will be very curious to see what the EU does as we try to penetrate that market more.

Thank you, Mr. Chairman.

Mr. OSE. The gentleman from Georgia?

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

Mr. Csiszar, could you tell me how state price controls have harmed small business owners? For example, are consumers restricted in their ability to have auto collision repair in highly regulated states?

Mr. CSISZAR. I do not think I can really answer that question with any hard evidence, other than evidence out of South Carolina again. And I can tell you in South Carolina, it was not even the issue of whether they could get it repaired or not. In South Carolina, we had a real availability issue.

We had a reinsurance facility that covered both personal automobiles, as well as commercial automobiles. That market, that residual market, that reinsurance facility became the largest insurance company in the State.

And the end result was that, while insurance was available, it was not really competitive because very few other companies wrote in the State because of this large residual market. So we had to solve our problem in South Carolina based on the size of the residual market.

The losses, by the way, from that residual market were charged back to the consumer. So if you are asking how did the consumer suffer? He suffered, either on the personal auto or a commercial auto, by having to pay something called the "recoupment fee."

And that recoupment fee, the losses in the facility were at $240 million, $250 million every year. That all got charged back. So that is probably the direct impact that we experienced in South Carolina, at least.

So I can only answer it from that perspective.

Mr. SCOTT. But do you see that this is may be one of those areas where there may be some evidence where the cry for national regulation might have some substance?

Mr. CSISZAR. Again, the problem with national regulation, as we see it in South Carolina, the homeowner and the automobile owner in South Carolina does not want to pay for the losses of that individual in California or in Florida.

Mr. SCOTT. Okay. Are property and casualty insurance inherently state and local issues, in your opinion?

Mr. CSISZAR. Sorry, I missed the last part.

Mr. SCOTT. Are property and casualty insurance inherently state or local issues?

Mr. CSISZAR. They are inherently state issues, local issues. As Mike said, torts come into the picture. And tort law is on a state basis.

Coverages are very local. For instance, in our state, we only need earthquake coverage in one particular part of the State and that is the Charleston area because it experienced an earthquake in the late 1900s.

Nowhere else in the State do we have that kind of earthquake activity. So there are some peculiarities, both based on geography, also based on population. As Mike said, rural versus urban, for instance. Automobile insurance in an urban area is a different creature from one in a rural area.

Mr. SCOTT. What is the effectiveness of rate controls in the States?

Mr. CSISZAR. Those who have them in place will tell you that they are God's gift. And those who do not have them in place think they have a better market. There is no unanimity on this issue, Mr. Scott.

Mr. SCOTT. Do you think they are holding down rates? Or are they restricting competition?

Mr. CSISZAR. Again, I can only speak for my state. In our case, the reinsurance facility became a method of rate suppression. And hence, we had to get rid of it.

In other states, others tell me, my colleague in North Carolina tells me that his prior approval system is working just fine. And if you look at the statistics, he is somewhere around average always, much like Illinois is.

So it is hard to tell. Different models.

Mr. SCOTT. One final question. What do you think of the idea of creating a self-regulatory organization to oversee insurance matters, similar to the securities industry?

Mr. CSISZAR. I think the industry would love it. But I do not think it would be the right solution to the problem.

I really think that our regulatory system, Mr. Scott, has worked fairly well. While I am the first one to sit here and admit that God, yes, we do need some reform on the uniformity issue, for instance.

In other respects, it has worked quite well. We have not had a savings and loan fiasco. We have not had a BCCI in this industry.

We have not had the problems that the mutual funds are experiencing. We have not had an Enron in this. So I can go on and on. I think in that sense, we have really served the consumer well.

Mr. SCOTT. Our Ranking Member Kanjorski, as I understand his opinions on this, is not necessarily clear that the States can handle this and that we may have to look at a national reform, a national regulator. Could you tell us, in your own opinions, what damage a national regulator would do?

Mr. CSISZAR. It will eviscerate the State system. You might as well start from scratch. And I feel that there is such expertise at the State level. And I think there is such good response to the consumer at the State level, that that step is not necessary.

Now I will agree with Mr. Kanjorski that the proof will be in the pudding. We better deliver on this one. I would be the first one to say that if I come before this committee 2, 3 years from now—God forbid I should still be in this position—but if I do come before this

committee 2 or 3 years from now, you can hammer me over the head because we do need to deliver.

But I think the timing is such that we can deliver. And we want to be given the chance to be able to deliver, to prove to you.

So we welcome the oversight. I welcome the pressure that this exerts because it instills a sense of urgency in us to do this and to get it done.

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

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. OSE. The gentlelady from New York?

Mrs. KELLY. Thank you, Mr. Chairman.

I chaired a hearing on market conduct oversight in the Oversight Subcommittee last May. And I was amazed at some of the requirements that contribute to the cost of doing business in some of these states.

Like I am going to just give a few examples. Massachusetts has a checklist for their speed to market initiative that is 230 pages long. Wisconsin requires companies to put a slash through all zeros on policy form transmittal, which requires going over the form by hand to put the slash in.

Nevada requires their filing fee document to be on the top page. Arizona requires insurance company names to be fully spelled out. There are no abbreviations.

Colorado requires an original signature on every state form. Missouri requires a stamp of an insurance company's name on each attachment of a rate filing.

Nevada requires pink paper to be used when submitting the filing fee document page—pink paper. It is Nevada. Kentucky has requirements for stapling. But if you file in Kentucky and in Ohio, you have to pull the staples out because Ohio does not allow paper clips or staples in their filing.

Now this is ridiculous. And it is a cost-consuming kind of thing to have this kind of stuff going on.

So my question is: if Congress required a nationwide uniform documentation and market conduct review, would the consumers benefit in the immediate future? I am asking all of you that question.

Mr. CSISZAR. I will begin and I will let Greg take over as well. But I will add another one to you. It took me about 3 or 4 years to find out that we were not accepting parentheses in our documents because somebody 20 years ago decided that that is the way to slip in things into an insurance policy, by putting it into parentheses.

It is embarrassing when I listen to something, to that litany, it is absolutely embarrassing to me that we sit here to even have to discuss this sort of thing. This is sheer, utter nonsense—utter nonsense. And I do not think you will get any disagreement from the commissioners on this.

Part of the problem has always been the bureaucracy. You know, as I said, it took me 3 years to find out we were not accepting parentheses.

Part of it I think is the bureaucracy and driving that change through the bureaucracy. Part of it I think has to do with the fact that you have these desk drawer rules.

So I think the market conduct process, as we envision it now, whether it be ultimately through a model we are developing or in the midst of developing or through the adoption of the NCOIL model, will specifically avoid that sort of thing, plus the fact that fact that you have SERFF in place now. And it is a common filing through SERFF. You do not have all these added little rules, unless you file on a state-by-state basis without using SERFF.

But we now have what, 50 states? All states are on SERFF. So I think a lot of this will go away. But I have heard these things. And I blush and I am embarrassed when I hear about them.

Mrs. KELLY. Well, my basic question is: do you think the consumers would benefit in the immediate future if we require a uniform documentation? SERFF may be the answer to that, but is that going to help consumers? I am really looking at how this is going to help folks.

Mr. SERIO. Yeah, I think it will. Whether you do the uniformity approach or we do it through the interstate compact and other initiatives and get out of the paper business altogether. It cannot be overstated the importance of SERFF, both for the States and for the companies to together be a part of this.

We have to balance this out. And you heard all the horror stories in market conduct. And we were enforcing the law of pink paper against the companies.

At the same time though, you have the balancing of the incomplete applications, the applications that had things in parentheses because they were trying to do something else other than what the product was purported to be. Getting to uniform standards, getting to uniform mechanics of filing and approving these products cannot do anything but help the consumer, from a couple of perspectives.

Number one, the cost that is built into the product of designing the product and getting the product approved, right off the bat, that is a built-in cost of the product.

Second of all, it is the cost to the consumer as taxpayers, not just of the insurance department where we are largely funded by assessments on the industry, but it is all the other apparatus in state and federal governments—the consumer protection boards, the attorneys general, the others who will undoubtedly get into the middle of this consumer issue—where the taxpayer is paying for this several times over.

Bringing uniformity, bringing clarity—maybe that is almost a better word for it—bringing clarity of the process and the requirements on each side, what is required of the departments, as well as what is required of the companies, I think that clarity can only help the consumer.

When Governor Pataki was first elected in 1995, his second executive order was to shed all of our regulations of the type of things that you just spoke about: get rid of the desk drawer rules; get rid of the commas and the paper clips and all those other issues that did not bring any value added or any added value to the protection of the consumer and the delivery of the business in the State of New York.

And other states have done this. Other governors have done the same thing.

That is really what has to happen in terms of this wholesale approach to clarity. And I think the electronic processing certainly goes a long way to getting that.

Mrs. KELLY. Thank you very much.

Mr. OSE. We have heard a lot about Kentucky. Now we are going to hear from the gentleman from Kentucky.

Mr. LUCAS. Thank you, Mr. Ose.

I am an old life guy. And I come from those prejudices. And I admit those upfront. But after 31 years of frustration with getting product to market, that is sort of in my craw.

And I guess one of the things, when I came to Congress, I thought there was a lot more knowledge here with the body corporate of insurance matters, both P&C and life. And I was surprised to find out there was not a lot of knowledge.

Mr. David Woods in his NAIFA testimony brought out one thing that I thought showed the lack of understanding here in this body about life insurance in particular. In the victims' compensation settlement after 9/11, we passed a law that people who provided for their families with life insurance—and really, for the price of a set of golf clubs, you could have bought a couple of boatloads of insurance to protect your family.

But the victims' compensation did not take into account stocks, bonds, savings accounts, inheritances. But if you had life insurance, then that was subtracted from your settlement, from people who were responsible about their families.

That has always bothered me a whole lot. That does not have anything to do with anything here, but I feel better about having said that.

[Laughter.]

And also, the other thing, we talked about 1861 and it is 2004. And according to my math, that is 144 years instead of 134 years, but what is 10 years? It is like a nanosecond when it comes to insurance regulation, right?

But you know, I have been for the optional federal charter. And I stated that. And it is probably the most astounding thing I have said since I have been here in Congress, the reaction I got.

But basically, I think what we need to do is to level the playing field. And frankly, I do not care how we do it. Just let's do it.

And, I mean, for all the duplication there is in the 50 states about the same duplicitous things that people go through. It might take a couple of years to approve a product when in fact the banks—and I have been involved with banks and mutual funds, I have been involved with those too—you know, they can go have a product right away and the life insurance company takes forever. That is not right.

And so all I am suggesting that we need to do is let's just do something. And let us level this playing field.

And my thought is, if we do not do something about it, we might do something up here that you may not like. And so let's move.

And I do not know that I have a question. And I might state too that the Kentucky Insurance Commission modernized back in the 1950s and went to paper clips. So I want you to know that we are moving right along.

[Laughter.]

Mr. OSE. The chair recognizes the progress in Kentucky.

The gentleman from Alabama?

Mr. BACHUS. Thank you, Mr. Ose, for recognizing me.

I would start with Mr. Serio. Mr. Serio, do you think that properly targeted federal legislation may either assist or encourage or push certain states to coordinate and achieve more full participation in some of the key NAIC programs that you all have?

Mr. SERIO. Yes. I do not think there is a question about it. I think we saw it with NARAB. And I think you were very helpful with that.

I think we have seen the States acknowledging that the partnership that they have with the federal government and with the Congress as the policymaking body specifically, where we dealt with it in the Fair Credit Reporting Act reauthorization and the preemption in that case because in that case, that was the best way to go. But I think that, again coming back to the old line of the devil is in the details, we want to make sure that whatever we work on together makes sense back at that local level.

Because so much of this business—and I will even go so far as to say even with the discussion we have had so far today, that even life insurance, while uniform in terms of its product design—and that is why the NAIC has been focusing on life products in the interstate compact standards as the first place to go—it is still largely a locally distributed product. So I think that balance between federal policy, state implementation, state regulation, is a good balance that I think we have seen the success of that formula several times over.

Mr. BACHUS. And let me ask you and Mr. Csiszar both, Walter Bell's committee is working, other committees, is it possible for you all to actually, if you run into a road block, to actually recommend to us some specifically-targeted federal legislation that might actually you may find needed to break through on some of these?

Mr. SERIO. I think that is part of the ongoing dialogue. I can tell you that the NAIC and the individual states have had what has been an unprecedented level of involvement, cooperation and partnership particularly with the House Financial Services Committee.

So I think before we can come in and advise the committee that there is a problem, I think the committee will know it because of the ongoing dialogue that we are having and because the chairs have made themselves available to come to the NAIC and speak to the commissioners directly and because the NAIC has been expending as many resources as it has to have New York, South Carolina, Washington and other commissioners—Delaware is here today—come to Washington and pursue this dialogue. I think it will almost become unspoken that when you see if there is some difficulty, you will see that as a recognition that we can probably use some assistance in terms of moving forward on what has been the uniform goal of uniformity, both between the States and the federal government.

Mr. BACHUS. All right.

Anybody else?

Mr. KREIDLER. If I could just offer a quick comment relative to Commissioner Walter Bell's work on speed to market? One of the

real challenges was to be able to come up with product standards for life and annuity products. They have done a commendable job.

And we are in the process of approving those product standards by the NAIC. And it is a critical part of moving forward with the interstate compact.

Because once you have product standards, you have something that state legislators can take a look at and say, "We are not going to disadvantage consumers if we go to these particular product standards. Therefore, we are willing to step into an interstate compact."

I mean, we all know that interstate compacts have not been warmly received by a number of states as a general concept, particularly if they are going to be a depository for nuclear waste or something of that nature. But in this case, we have product standards.

And it is the work of Commissioner Bell through speed to market, where we have those now. And I think you are going to see states moving aggressively now to join the interstate compact because they have something in hand now. They have these product standards. And that means speed to market.

And so I am very optimistic right now we are going to see a lot of progress. And Commissioner Bell from your state has played an incredibly important part of making that happen.

Mr. BACHUS. Okay. And my next question to any of you all that care to answer: does it make sense to have some sort of a state-federal council to help coordinate certain areas of insurance policy or to speak for the industry? I will give you an example.

Now we have the federal government regulates insurance in a number of fields, like the terrorist insurance. On legislation, we had flood insurance, health insurance.

And I often hear that there is nobody at the table representing the insurance industry, say in trade talks. You know, there is someone that speaks for the financial industry. But there is no one at the table for the insurance industry.

Does some sort of federal-state council, I mean, if we could establish that with your input, would that be something you would be willing to pursue?

Mr. CSISZAR. Let me take that question and my colleagues may want to comment on it as well. A couple of things about that.

I think one of the reasons why we are even discussing this issue of representation at the federal level has to do with the fact that—blame us. In years past, not until very recently, the NAIC has not been at the table.

There has not been anyone really here in Washington; and I think deliberately so. When you look at the Gramm-Leach-Bliley process, for instance, we did not get involved until the very end. You know, by then, the train had left the station.

So I think the first comment I would make is I do not think you are going to have as many of these representation issues as we did in the past because we are here now and the industry is here and the consumers are here as well. That is number one.

Number two, the fear that I have about setting up any kind of separate federal body is that it becomes the prototype for something like what we have with the OCC. And quite frankly, as you

know, there are a great many of the problems, most recently this preemption of predatory lending laws, stemming from the fact that you have had someone like the OCC representing the banks here.

What I would propose to do and what I have proposed to the industry—and in fact, the industry approached us. I should not say the industry—the ACLI and I have had discussions. Many of these representation issues come down to tax issues.

Why don't we form a joint NAIC industry group to address these tax issues in Washington? We are here for you. We have the expertise. I think that representation can come as a natural part of that.

So rather than having this risk of an OCC confusion between what does that coordinator do? And where does coordination stop and regulation begin, for instance? Rather than having that take place, my suggestion would be that the industry and the NAIC get together and do this themselves.

Everybody else does it the same way, really. I mean, you do not see a manufacturer represented by an OCC on a tax issue, for instance. So I think we can——

Mr. BACHUS. But of course, you have the Department of Commerce with manufacturers. With the financial institutions, you have the Treasury, the Fed. There is no one.

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

Mr. BACHUS. Okay. Could I change subjects and ask one more question?

Mr. OSE. The gentleman asks unanimous consent for one further question.

Mr. BACHUS. And I am just making this almost more of a statement to preserve time. I mentioned in my opening statement the reinsurers. You know, reinsurers contract with insurance companies, not with consumers.

So I would simply say—and I hope you agree—that it could meet, the States could meet more uniformity in how they treat the reinsurers and that you do not have the consumer component.

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

Mr. BACHUS. And they are all nodding their heads in agreement, I think.

[Laughter.]

Mr. OSE. Let the record show.

The gentleman from Washington?

Mr. INSLEE. Thank you. I wonder if you can talk, just sort of from the consumer's side of the coin for a minute, about the prospects of specifics on protecting consumer's rights if we do have legislation? Just one idea, there are numerous ones I suppose could be considered, but this issue of privacy.

You know, we are outsourcing a lot of functions overseas now of a lot of back room operations. And there have been concerns expressed about maintaining consumer privacy. There are 1,000 other things that we might incorporate in a consumer bill of rights or a consumer's kind of interest specifically.

Is that something that we ought to at least think about if there is legislation? If so, how should we think about it?

General question for the wisdom of the panel.

Mr. KREIDLER. Mr. Inslee, I would say that having some statement here of assurances that changes are put forward by the Con-

gress to make sure that consumers, with these changes, are not disadvantaged, that they have protections under the current state system. And as changes are being advocated, hopefully on a very targeted basis.

But even with those changes, if you could make sure that there are not compromises made for consumers. I think that is an important part of making sure that what might be good for the sellers of insurance is also good for the people who purchase them and that their rights are adequately protected.

Mr. INSLEE. I think I missed some of your testimony. You talked about access to FBI files or at least fingerprints.

Could you give us an example of why that may be important?

Mr. KREIDLER. We had a very good example—actually, many of them, but one of them in particular—where had an individual who was in good standing in one state that does not require a fingerprinting background check as a part of being licensed as an agent or a broker in their state, that applied for a non-resident license in the State of Washington from that state. And when we did the background check—this is a person who completed the form and said they had no felony convictions in their history.

And when it came back, I believe the number was nine felony convictions, several of which were in the financial services area. This is somebody that obviously never responded when we pointed this out to them, so they did not attempt to get licensed in our state. But in that state where they are a resident and are an agent in good standing, they continue to do business.

I think that is one reason why I think that there should be uniformity in order to achieve that producer or the agent licensing standard uniformity across the country. This is one of the things that, quite frankly, should be there in order to make sure that we do not have some bad actors out there that are going to cause some real problems for consumers.

Mr. INSLEE. Thank you.

Mr. OSE. The gentleman yields back.

The gentleman from California?

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman. This is an issue that I have great passion about. I used to be on the legislature in California and the insurance commission. And we have talked about things. And I think you have been very articulate talking about insurance regulations and the need for more efficiency and uniformity and basically to become more effective to consumers.

And in the past 5 years, I have grown more passionate about the concept of an optional federal charter. And I know you disagree with that.

So talking in the direction you are about coming up with some form of uniformity, although it seems like legislatures have been a barrier to that in a past, and effort toward a system that is more systematic in reforms and regulatory uniformity from state to state to accomplish what you are talking about, sounds good. But I have a letter from John Giramendi in California. And he is not interested in this.

So in order to have some form of national uniformity in the industry, you have to have an agreement that everybody is going to

be willing to participate. Now in an optional federal charter, it is optional.

If an insurance company wants to be an optional federally chartered insurance firm, like banks are, they can. If they want to be a state, they can.

But how do you expect to achieve any kind of uniformity based on what you said in your opening comments? And I applaud you for your concept. I do not disagree.

But how do you expect to have any form of uniformity when states like California, with large populations, have already announced their opposition to this concept?

Mr. KREIDLER. One thing I would point out is that several of the very large states are already in the process of considering an interstate compact. And I think it is only a matter of time—shortly—of being able to convince their legislatures to participate, particularly now that we have the product standards.

It has been introduced in the State of New York. It is going to be introduced in Florida and Texas.

I think we are going to see a number of those larger states coming in. At some point, there may be a need to address the problem federally to make sure that some of the outliers come in, if in fact that happens.

Mr. MILLER OF CALIFORNIA. So you are acknowledging that there might be a little more requirement of a federal participation in this process as it goes along?

Mr. KRIEDLER. I think if you get to the point where you have that almost near unanimous already, it may be necessary. There are always legislatures that can be a little bit more cantankerous in addressing uniformity than others. They had the same kind of problems that the Congress has among its members in trying to get unanimity on complex issues.

But if I might just say about the issue of an optional federal charter, we have a good example of what happens when you have the ability to effectively forum shop for regulation. In the State of Washington, there is currently—and it has been written about in the New York Times—a large company that deals with financial services, that was going to be put out of business a decade ago in the State of Washington and really reigned in. That company made the jump to a federal regulator by being listed on one of the major exchanges and then coming out from underneath the State regulation.

They are currently, just recently within the last year, have gone into federal bankruptcy court. The major asset of that corporation is a life insurance company, which I now have in receivership.

This did not need to happen. It would have stopped way back 10 years ago if you did not have the chance to effectively shop from one forum to another.

Mr. MILLER OF CALIFORNIA. But on that vein, I will give you a great current example in California—worker's compensation insurance. And you have businesses lining up to move out of California. This is one example of one state, that their insurance commissioner said they do not like the approach we are taking today in this hearing.

And you have other states that are not having a problem with it. Yet even though it is recognized that it is costing us jobs, it is killing businesses in California, you have state legislators that are in a mindset that they are just not willing to change because they do not want to change.

And you have insurance commissioners who like having total control over what goes on in their state and legislators who want to have total control and do not want anybody outside influencing or dictating to them what they are going to do. How do you change that in reality, in the way you are proposing to go, when it is very optional on their part?

Mr. KREIDLER. Well, one item I can point to right now, California is participating in a memorandum of understanding with Texas and with Florida. And from the standpoint of premium volume nationally, it is a very large percentage, where you can make one filing on a life product and you will be able to be approved in three states at one time.

So they are showing progress in that——

Mr. MILLER OF CALIFORNIA. Life products are much simpler. But that is a good start.

Mr. KREIDLER. Life products is where we have the biggest issue relative to uniformity across the country. Property and casualty are much more regional and state driven.

But I believe that you are going to wind up with some states, as I said, that are, just because they take a very provincial interest, who may need a nudge in order to finally get them——

Mr. MILLER OF CALIFORNIA. Or a gun.

Mr. KREIDLER. But I would not be surprised to see California, quite frankly, join the interstate compact.

Mr. MILLER OF CALIFORNIA. I am anxious to see this process as it proceeds. I applaud Chairman Baker and Oxley for starting these hearings because I have come to believe strongly in the past 5 years. Ten years ago, I did not believe it. But 5 years ago, I started to believe there was a need for an optional federal charter.

Maybe this is an option to that. And I am anxious to watch us go through the process because I believe there is a very severe problem out there nationally in this industry.

I think we need to do everything we can to help them and help consumers at the same time. They go hand in hand, the way I look at it. And so I am anxious to see any proposal that can come forward to help alleviate some of the situations we are in.

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

The chair would advise members we have one vote on pay parity on the floor at the moment. We have a couple more speakers, including Mr. Pomeroy, who has joined us.

The chair's pleasure is to continue for as long as we can, then we will take a short recess, to the extent we have to, and then reconvene accordingly.

The chair would recognize Ms. Maloney.

Mrs. MALONEY. First of all, I would like to welcome Mr. Serio from the great State of New York and congratulate him on his work. But I would like to ask the last speaker, if I heard you correctly, you were saying that this company that went bankrupt, it

was because of moving from various charters that they went bankrupt. Is that what you are saying?

Mr. KREIDLER. What they had the option of doing is essentially moving out of state regulation by effectively coming under federal regulation that would preempt the State from having a regulatory responsibility.

Mrs. MALONEY. And then you allege that that was the reason that they were in receivership. Is that what you said?

Mr. KREIDLER. They would have been stopped 10 years ago. And the risk to ..

Mrs. MALONEY. So you feel that if it had been under the State only and not able to shop—as you said, go to federal or whatever—this problem within the company would have been found. Is that what you were saying?

Mr. KREIDLER. My point would be that if you go to an optional charter, there inevitably is going to be forum shopping involved, relative to how they do business and how they believe that they will be more favorably treated. I would say this relative to insurance regulation: either leave it with the States or take it all to the federal government. But trying to find something in between will invariably open the door for that kind of forum shopping that will be a disservice overall to the financial services community.

Mrs. MALONEY. I yield my time to the distinguished former insurance commissioner from North Dakota, Earl Pomeroy. And I would like his comments on this.

Mr. POMEROY. Thank you very much, Congresswoman Maloney. I just have a couple of observations. And I know we have a vote on.

I believe state insurance commissioners have started down a dead end by advancing multistate compacts. I have never seen one passed. Superintendent Serio, if you can get the New York legislature to adopt participation in a multistate compact for purposes of bringing their filing standards into line with other states, that would be one tremendous legislative achievement. And I will be shocked.

But I look forward to seeing it. So much has been achieved over the 150 years of State-based regulation by state coordination: common policy forms, something as sophisticated as common risk-based analyses for purposes of determining reserve requirements, a national network of guarantee funds to help consumers when companies are insolvent. All of it achieved without actually requiring each state legislative body to take their own step.

When we established the standards, legislative action was required at the State level if a state was to comply with the standards and get the beneficial treatment that flowed from that. But to actually expect through the compact route we are going to get uniformity, I think is unlikely.

You have also given a flat bulls-eye for Congress to evaluate, in a simplistic and maybe not particularly fair representation, what is occurring at the State levels. They will see three, four states and they will say, "It does not work," without really looking further at all that has been achieved through the State level.

On the other hand, I believe that the chairman's proposals would require members like the sitting chair, Congressman Ose, to vote

at the federal level to lift state consumer protection authority from their state insurance commissioner. That also, I believe, is a stretch, to believe that that is likely to be achieved federally.

Over my 8 years of being insurance commissioner in North Dakota, I came to believe that the regulatory format designed initially by Dr. Phil O'Connor, who will be testifying in the next level, and implemented in Illinois, did achieve a very functional marketplace. The results were evident through the way that market worked. I admired it.

I am not sure it is Congress's job to save a state from themselves. I generally like to think the market takes care of this.

If I screwed up when I was insurance commissioner, we had capacity ramification. I had to un-screw up so that the market came back.

I think that we do achieve some significant tension to make states move toward having their markets function. I think people looking for a federal response that is going to save them from state legislatures are unlikely to see it, especially in short order. I mean, it is just unlikely that we are going to preempt, I believe, such a wholesale authority of consumer protection that exists at the State level.

On the other hand, I think there are other parts of the chairman's proposals that maybe do allow us an expedited way to truly put in place a uniform speed to access system without this cumbersome, unwieldy and unlikely state compact. And that is where these talks could really have some interesting outcomes as they proceed.

Thank you for indulging me, Mr. Chairman. And I yield back.

Mr. OSE. The gentlelady yields back.

Mr. Shays?

If the gentleman from North Dakota wishes, we would be willing to give him time, having been so patient.

Mr. POMEROY. That is very kind. And I would be interested—quickly, because we are going to have to run and vote and it is a good long ways from here.

Mr. OSE. We have about 7 minutes to go on the vote.

Mr. POMEROY. President Csiszar, I would like your response to my thoughts.

Mr. CSISZAR. I do not think anyone has any misconceptions, certainly the commissioners, how difficult it is going to be to get the interstate compact in place. However, the very fact that I think, under the umbrella of the interstate compact, we are developing national standards essentially for products, those national standards will be there regardless of whether a state adopts the interstate compact or not.

So the collaborative effort that you are describing that has worked in the past is not precluded by an interstate compact. In fact, I think it will be eased.

One of the problems we have had with even discussing the interstate compact is the fact that we do not have the standards to go with that compact, okay? But the compact and the standards, in a sense, are independent of each other. So the collaborative effort that we can undertake once we know what those standards are going to look like, that can continue, I think.

But at the same time, the fact that you have pressure coming here from Washington does not hurt, so far as we are concerned, you know?

Mr. POMEROY. Superintendent Serio, what do you think?

Mr. SERIO. Since the interstate has been introduced in the State senate at the request of the insurance department, I have maybe a little more faith that the New York legislature will look at it. And I think one of the things we have tried to do and by the NAIC taking on the interstate compact as a model, that was actually originally put forward by NCOIL so many years ago, we have taken some of the mystery out of it.

In New York, which is involved in dozens of interstate compacts, both policymaking and operational, I think we are working towards reducing the mystery of this as an insurance policymaking mechanism. So I think on the one hand, we have good hope. Three states have already passed it and signed it into law. I think there are two or three others that have it on their governor's desk or will be shortly.

So within its first 4 months, it has had some positive developments. But as Commissioner Csiszar said, the bottom line is that the uniformity push is already happening. And whether it comes through an interstate compact or comes through some assistance from the Congress or just through the regular activities of the NCSL and NCOIL in the State legislatures, we are already well on our way to that uniformity standard in whatever way it manifests.

But I think the interstate compact, because it has been done with the cooperation of the NCSL and NCOIL and the NAIC, I think the interstate compact has a better than fair chance at this point because of that coordination, maybe for the first time, between the commissioners and the State legislators who are going to be asked to act on it.

Mr. KREIDLER. One feature here that does not require any legislative action right now is a memorandum of understanding. And we already have three of the largest states already essentially beginning the process of accepting filings for life products right now. And that is not going to require any legislative change in order to see that process work.

And they represent something like 20 to 30 percent of the premium volume in the whole country. So this is one where we are already seeing some progress in this direction.

Mr. POMEROY. See, I actually think, had interstate cooperation been based on pemorandums of understanding, as opposed to interstate compact requiring legislative action, you might have been better off. Of course, legislators want to get their hand in insurance regulation, but not for the purpose of conforming with national models, but to tinker in the business. That is what state legislators do.

Mr. OSE. The chair is going to intercede here. We have about 4 minutes.

Mr. POMEROY. I yield back. Thank you, Mr. Chairman.

Mr. OSE. The gentleman yields back.

We are going to take a 5-minute recess. Mr. Baker is on his way back.

In that period of time, if we could get the second panel together. We thank the first panel for their testimony and participation. We are adjourned—we are recessed for 5 minutes.

[Recess.]

Chairman BAKER. [Presiding.] If I can ask everyone to take seats, we will reconvene our hearing. I wish to welcome participants on our second panel. As is the usual custom, your official statement will be made part of the record.

We request that, to the extent possible, your statement to the committee be limited to 5 minutes. And be assured that members will be coming and going through the course of the afternoon.

The combination of the vote and the lunch hour, I think, has caused our numbers to be decimated a bit. But they shall return.

But not to unreasonably detain anyone, I felt it appropriate to proceed with our witness and to first welcome Mr. Ahart of the Ahart, Frinzi and Smith Agency, but appearing here today on behalf of the Independent Insurance Agents and Brokers of America. Welcome, sir.

STATEMENT OF THOMAS AHART, AHART, FRINZI AND SMITH AGENCY, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

Mr. AHART. Thank you, Mr. Chairman.

As mentioned, I am an insurance agent from New Jersey. I have been in the business for about 30 years. And I am also a past president of the Independent Insurance Agents and Brokers of America, which I served as president from September 2001 to September 2002.

I think that being in the business for 30 years puts me in a pretty good place to speak as far as consumers and agents go. As agents, we are in between both the consumer and the companies.

We deal with companies every day. We sit and listen to consumers and work with their problems every day.

To begin, I would just like to say that the IABA strongly supports the approach that you, Mr. Chairman, and Chairman Oxley have developed. Specifically, we praise the approach of targeting the use of federal legislation to modernize the core areas of state insurance regulation. Also, we strongly support state regulation. It has worked well for years in areas including consumer protection. Consumers want and like to deal with someone in their own state who understands the problems and the needs in their specific regions.

But even though state regulation has worked well over the years, global modernization and improved technology have created demand for more uniformity among states. The demand for more uniformity has created a need to modernize state regulation.

Again, we agree with the Oxley-Baker reform road map that is using targeted, focused and limited federal legislation, while at the same time preserving state regulation.

Let me address some of the major issues in need of reform; specifically, speed to market issues and licensing issues. With respect to speed to market issues, there is a need to improve the ability of new products to be introduced.

With technology, there are a lot of businesses now that are creating new exposures for themselves that are not able to be protected because new products are not able to be approved quickly enough. And so we would like some kind of reform that helps those issues where products can be developed quicker and approved quicker.

We would look to use a file and use proposal, whereby companies could begin using—could file a product and then use it after 30 days. It would give time for the States to still regulate, look at a product. But it would speed up the approval process.

In addition, we would like to eliminate price controls. Being from New Jersey, I have a pretty good background on price controls, especially in the auto insurance market. In the 30 years I have been in business, I can go from JUAs to excess profit laws to all kind of different laws that have created problems in availability and competition in the area of New Jersey.

This past year, we have actually had some reform, whereby some of the price restrictions have been reduced. And companies are starting to come back into the marketplace. And it is becoming better. But we definitely need more help in that area.

As far as agent and broker licensing, most states have enacted licensing reform statutes that provide reciprocity to licensed agents and brokers. However, various difficulties still remain.

Some larger states have not enacted the licensing reciprocity. And some states adopting reciprocity have deviated from the NAIC model; and therefore, are not uniform.

The bottom line is it is still very tough and time consuming to be licensed in multiple states. And yet, there is an increased demand from our consumers, both personal and businesses, to be licensed in multistates—where they are having branches in different states, where people are buying homes in different states. And we are continually asked to be licensed in more states to comply with their needs.

In addition, insurance companies still have a very difficult time expanding their licensing into other states. And it often takes years—not weeks or months.

Therefore, we propose the following with respect to agent broker and company licensing. With respect to national license reciprocity, we urge the subcommittee to expand the NARAB reciprocity mandate to all states.

Next, we need licensing uniformity. Additional uniformity is necessary in certain licensing areas. And a targeted federal proposal should help establish greater consistency for agents and brokers.

Third, we seek the outright preemption of all remaining mandatory counter-signature laws and similar barriers to effective multistate commerce. And with respect to insurance company licensing, we support a move toward a uniform set of standards or a common process for licensure of insurance companies that would apply in every jurisdiction.

If Congress enacts the law based on the road map, IABA recognized that a dispute mechanism is necessary to address disputes that arise under the act. Some arbiter will likely be needed to determine whether the States are acting in a manner consistent with a new law.

We believe in any such process or mechanism must be limited in its power and authority. Also, any new structure must not become a back door federal regulator.

Perhaps more than any other area, we would be interested in working with the committee on this portion of a proposal. And we look forward to working with you to make sure that no federal entity takes on any formal regulatory or licensing power.

So in conclusion, we would just like to say that we recognize that there are problems within this current state regulation. We believe strongly in the fundamentals of it. There are good things about state regulation.

We believe in your road map, which would attack specific areas; namely, speed to market issues and licensing issues. And with that, we thank you for letting us testify and look forward to helping you put together any formal legislation.

Thank you.

[The prepared statement of Thomas Ahart can be found on page 80 in the appendix.]

Chairman BAKER. Thank you for your statement and your assistance.

Our next witness is Mr. Roger Singer, senior vice president and general counsel of OneBeacon, who appears here today on behalf of the American Insurance Association. Welcome, sir.

STATEMENT OF ROGER SINGER, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, ONEBEACON, ON BEHALF OF AMERICAN INSURANCE ASSOCIATION

Mr. SINGER. Good afternoon, Mr. Chairman.

Thank you. As you said, my name is Roger Singer. I am the general counsel of OneBeacon insurance group. It is a multi-line property and casualty insurance company—companies, really. We have 28 companies in our group, licensed in all 50 states.

We sell products throughout the country, but mainly in the northeastern states. On behalf of OneBeacon and the American Insurance Association, thank you very much for inviting us to testify here today.

I also want to thank the subcommittee for leading the charge on the fundamental issue of state insurance regulatory reform. The concepts outlined in the subcommittee's action plan, particularly speed to market, if implemented correctly with enforceable national oversight, will protect consumers while bringing them the important benefits of an open, competitive marketplace.

I have been general counsel at OneBeacon for 15 years now. Prior to that, from 1987 to 1989, I was the Massachusetts insurance commissioner and spent approximately 10 years before that in various state government roles and I worked for the Federal Trade Commission on trade issues.

I have agonized on both sides of this issue, both in the public sector and the private sector. And I hope my perspective will be useful to the Subcommittee.

OneBeacon's national scope and regional focus gives us experience with the full range of insurance regulatory systems employed and administered by the States and the District of Columbia. Let me start with a few numbers we assembled.

Fifty-six, the number of U.S. insurance regulatory jurisdictions operating independently of one another. And I think I have personally dealt with 53.

Five hundred and fifty, the number of state requirements relating to the filing and review of rates and forms. Four hundred and fifty-four, the number of filings made by OneBeacon last year, just in our eight core states in the Northeast.

Add up the months and even years that it takes to review a company rate or form filing and one does not have to be an actuary to calculate the cumulative inefficiency the State insurance regulatory process imposes on the marketplace.

With this regulatory backdrop, I would like to focus my remarks today on three concepts outlined in the subcommittee's action plan: first and most important, speed to market; that is rate and form approval; secondly, national oversight; and third, company licensing.

Like other AIA members, OneBeacon supports a market-based optional federal charter system as the best way to achieve needed reforms with the least disruption to the State system. However, we are pragmatic about the pace of reform in the short term.

Done correctly, with appropriate reliance on market forces, the types of targeted reform the subcommittee is advancing could and would lead to national uniformity, reduced regulatory red tape and enhanced consumer protection. We understand the subcommittee's goal with respect to rates is to eliminate price controls and to instead rely on Illinois-style free market competition.

We applaud the goal because government price controls do not work to the benefit of anyone, especially the consumers of the insurance product. The Massachusetts automobile insurance market provides a stark example of the unintended consequences of price controls.

In Massachusetts, auto insurance rates are set by the insurance commissioner unless the commissioner determines that sufficient competition exists to assure that rates will not be excessive. The determination often turns on whether a finding of competition will result in immediate rate increases.

Inevitably, because of the political risk that rates might rise in the short term, such a finding is never made and rates continue to be set by the commissioner. This was the case when the very first decision under this law was made in the 1970s. It was the case when I was insurance commissioner in the late 1980s and is still the case today.

There is plenty of evidence that eliminating Massachusetts' price control system would result, over the long term, in lower auto premiums and a healthier market. Compared to Illinois, Massachusetts falls far short on a number of counts, including average annual auto insurance premium, number of drivers in the residual market and the number of insurers actively competing for business in the State.

These differences are not surprising. Price controls can have the politically expedient short-term effect of holding insurance rates down. However, if left in place, the controls act as an artificial pressure cooker that hurts competition, masks systemic costs and leads to higher prices.

I would like to spend just a minute talking about the regulation of policy forms. In jurisdiction with strict product controls, government review can take months or years from filing to approval. Product denials are often based on unpublished, arbitrary desk drawer rules with tenuous connections to state law.

This process is especially frustrating for companies trying to roll out products regionally or nationally. The system provides no incentives for insurance product innovation. In turn, consumers have fewer marketplace choices and no real basis to compare insurers by the products they offer.

Three principles should underlie the Subcommittee's review of policy form regulation. First, if premarket form regulation must be retained as a general rule, a market-friendly construct should be adopted, whether that is an informational filing or file and use system.

Second, government review of forms must be based on clear and specific statutory standards.

Third, commercial policy forms should not be subject to any state review or approval. Any commercial policy holder should be able to buy insurance products tailored to their specific needs. And those products should be available without delay.

I believe you will hear concurrence on this point from my colleagues representing RIMS and CIAB. The reason I brought this large stack of paper—it is not my testimony—on the table here today is when I came down here, I went looking for a filing that represented a product from my company.

We have a subsidiary that is a true Internet-based auto company. And it probably would not be—it is not—attractive to all consumers. But tech-savvy consumers like it.

It is truly Internet-based. You just go on the web. You do not talk to anybody on the phone. You buy your product. You get your policy and print it on your home printer.

You pay by credit card. Many consumers would not be comfortable with that; but many are. And we are building a pretty good business.

However, for that company—it is called Esurance, a sub of OneBeacon—for Esurance to do business in this state and each of the 50 states where it wants to file a form—and one of the advantages of the Internet is that it can make changes quickly and consumers can benefit from changes in product design and changes in price and the efficiency of Internet production—it has to make a filing.

And this is an example of a filing recently made by Esurance in one state. If it wants to change to a new product, it has to make a filing in all 50 states.

Some will be more extensive—not many—than this; and some will be simpler. But the issue is that this product that is available to customers all over the country is tied down to a pretty antiquated system of form approval.

Turning to the issue of national oversight, attainment of the subcommittee's goals for true marketplace reform will require strong national enforcement of preemptive federal standards. It is unrealistic and raises constitutional problems to expect states to enforce

federal standards, let alone to enforce them uniformly and consistently.

Insurer experience with the Gramm-Leach-Bliley Act of 1999 provides ample evidence of the need for national oversight and dispute resolution. As a result, we strongly encourage creation of a national enforcement mechanism.

Finally, I will just say a word or two about company licensing. I am often involved in getting companies licensed. And as we have heard here earlier today, it is a process that varies from state to state.

Many states have windows in which you have to apply. And if you do not make the window that year, you wait until the next year.

What is being decided by the State in almost every case—well, what should be being decided—is simply whether the company is appropriate—a very, very important decision—and solvent and, financially and in other ways, responsible to write insurance in the State. For that to have to be decided individually by 50 different states with strapped resources seems to us an extreme inefficiency, which does nothing to benefit insurance consumers.

Finally, I would just like to say I want to thank the subcommittee for addressing these much-needed reforms in key areas. And thank you for the opportunity to testify. And of course, I would be willing to answer any questions.

[The prepared statement of Roger Singer can be found on page 171 in the appendix.]

Chairman BAKER. Thank you, Mr. Singer.

Our next witness is Mr. Albert R. Counselman, president and CEO, Riggs, Counselman, Michaels & Downs, Incorporated, appearing today on behalf of the Council of Insurance Agents and Brokers. Welcome, Mr. Counselman.

STATEMENT OF ALBERT COUNSELMAN, PRESIDENT AND CEO, RIGGS, COUNSELMAN, MICHAELS AND DOWNS, INC., ON BEHALF OF THE COUNSEL OF INSURANCE AGENTS AND BROKERS

Mr. COUNSELMAN. Thank you, Mr. Chairman. I am Skip Counselman. And as the CEO of RCM&D in Baltimore, I represent an organization which is Maryland's largest insurance brokerage. We provide risk management, commercial and personal insurance and employee benefit programs to a wide range of clients.

I also represent today the Council of Insurance Agents and Brokers, as a past chairman of that organization, the CIAB. We heartily embrace your road map, Mr. Chairman, to insurance regulatory reform.

Years of work have led to this proposal. And we believe it lays the groundwork for aggressive reforms that will go a long way toward providing desperately needed modernization in insurance regulation.

The pace of financial services convergence and globalization are far outstripping the pace of individual reform efforts by the States. Even though the States have made some strides in simplification and streamlining, as we have heard this morning, thanks to what you, Mr. Chairman, and to Chairman Oxley and to what Congress-

woman Kelly have accomplished in the enactment of NARAB, there still remain glaring irregularity and inefficiencies despite those efforts.

There are three major areas that could greatly benefit from immediate reforms, all of which are consistent with your road map. The first is to make the NARAB licensing reciprocity requirements apply to all 50 states.

The NAIC, despite its reform agenda, is not in a position to force dissenting states to adhere to any standards it sets. We believe the reform proposal should build on the NARAB provisions, taking it a step further by mandating that all 50 states enact uniform licensure laws or laws permitting an agent or a broker licensed in one state to be licensed in all other states on a reciprocal basis and preempting all state insurance laws that discriminate against nonresident agents and brokers.

While life is better for insurance firms such as ours because of NARAB, we still have to maintain in our firm 458 licenses. And there are many, many inconsistencies, none of which really have anything to do with standards of professionalism.

We encourage and are certainly for the highest standards. As we heard testimony this morning about the need for FBI record access that some states require, we certainly also agree with that, that we want the highest standards to apply throughout the country. So let's finish that job.

The second area is speed to market. My firm sells and services primarily commercial property and casualty insurance. This part of the industry faces severe challenges, due to a number of factors: 9/11, increased liabilities for asbestos, toxic mold, D&O liability, medical malpractice, years of declining investment returns and consistent negative underwriting results.

The end result has been increased prices and declining availability of insurance, all of which is exacerbated by the current state-by-state system. The worst examples are the policy form and rate pre-approval requirements still in use in many states.

More than a dozen states have completely deregulated the commercial marketplace for rates and forms. But many other states still have them.

We think the Illinois model is a good model. One quick example that I have personal experience with, with our association, we sponsor a captive insurance company that provides errors and omissions insurance to 65 of our member firms who are located in 35 states.

A couple of years ago, we needed to raise our rates and revise our coverage form to broaden the coverage. We had to refile the form in all of those states. And it took 2 years to get the approvals.

It also cost us over $200,000 to achieve the refiling. That was a waste of resources.

As I said, we support the complete deregulation of rates and forms for commercial lines of insurance and elimination of command and control regulation. Mr. Shays asked earlier: how do consumers suffer from overregulation? And the answer is: both in cost and in limitation of the insurance coverage forms that are available as a result of the slow process that we go through to get a rate regulation filing done.

Third, we think you should explore ways that alternatives to the traditional regulated marketplace can be fostered to provide a viable alternative for sophisticated insurance consumers. Increasingly, business is done through the surplus lines marketplace, which offers coverage for risks that are not available from admitted carriers.

The regulatory structure governing surplus lines coverage is a morass. When activity encompasses multiple states, regulatory compliance is almost impossible. The rules, particularly with respect to collection of premium taxes, are conflicting and inconsistent.

There should be incentives or requirements for the States to rationalize their irrational surplus lines requirements. As an example, this is 36 pages from the State of New Jersey, available on their website, which explains how to do a surplus lines filing premium tax filing, which is something agents and brokers must do when they place a surplus lines policy.

It is very specific with their instructions, including exactly how to keep the pages in order and how to number each item on each page. That would be fine if all 50 states abided by these same rules. But unfortunately, there are different rules in every state.

Finally, we think that risk retention groups have created a very good alternative market for liability coverage. And we would urge you to expand the risk retention act to allow coverage of property damage, as well as liability exposures.

Mr. Chairman, all of the regulatory modernization efforts put forward by the NAIC in the past years have been the direct result of major external threats—either the threat of federal intervention or the wholesale dislocation of regulated markets. The states' progress on producer licensing reform, thanks to NARAB, is a prime example of this.

We believe your road map is an excellent vehicle to keep the pressure on and force the States to make the reforms necessary to address the glaring deficiencies of the State system.

Thanks for the opportunity to work with you and your fine staff as you move forward. Thank you very much, Mr. Chairman.

[The prepared statement of Albert R. Counselman can be found on page 86 in the appendix.]

Chairman BAKER. Thank you, Mr. Counselman.

Our next witness is Anthony Dickson, president, NJM Insurance Group, appearing here today on behalf of the Property Casualty Insurers Association of America. Welcome.

STATEMENT OF ANTHONY DICKSON, PRESIDENT, NJM INSURANCE GROUP, ON BEHALF OF PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

Mr. DICKSON. Good afternoon, Mr. Chairman. And thank you, members of the committee. I am Tony Dickson, president of the New Jersey Manufacturers Insurance Group and here as chairman of the board of governors of the Property Casualty Insurers Association of America.

PCI is the most diverse national property casualty trade association. This diversity provides PCI with a unique perspective on insurance regulation.

PCI's board of governors unanimously authorized the filing of our statement and my presence here as an indication of our willingness to continue to serve as a resource to this committee. As an example of PCI's membership diversity, Mr. Chairman, the NJM Insurance Group writes 99 percent of its business in New Jersey, with premiums in 2003 totaling just under $1.3 billion.

NJM is one of the largest property casualty insurers in the State. New Jersey Manufacturers Insurance Company operates in the fashion of a mutual insurer, returning dividends to its policy holders.

PCI members share the common vision that competition and market-oriented regulation is in the best interest of the industry and the customers that they serve. PCI members believe that the current insurance regulatory system must improve.

Mr. Chairman, PCI shares your goal of strengthening and improving the State regulatory system without creating an optional federal charter, a federal regulator or a dual federal-state regulatory system. PCI believes that the greatest chance to achieve our shared goal of State-based improvement is a narrowly targeted package designed to address the core problem of the current regulatory system: namely, antiquated price controls that impose barriers to market-based pricing systems.

While other areas of reform are important, the single most significant element, overshadowing all other reform proposals, is the goal of insuring a truly competitive marketplace with open rate competition. PCI urges the subcommittee to place its highest priority on these reforms.

PCI supports open competition rating laws, as exemplified by the Illinois model, as the most desirable approach to rate regulation for the entire industry. Studies verified that consumers in states where competition is the primary regulator of price benefit from expanded choice, innovative pricing and improved insurance availability.

For example, Illinois, which has had competition-based pricing since 1971, has an exceptionally healthy personal lines insurance market. More recently, South Carolina has shown that competitive market reforms produce significant benefits for consumers.

In 2003, Mr. Chairman, my own state of New Jersey enacted a package of reforms of its automobile insurance regulatory system. Led by Governor McGreevy, legislators of both parties and supported by Commissioner Bakke, the Automobile Insurance Competition and Choice Act included: better information and choices for consumers, toughened anti-fraud measures, enhancements of the expedited rate filing statute, changes in the excess profits law and other positive regulatory provisions.

We are already seeing some improvements in competition as a result of these reforms. And New Jersey drivers now have access to more companies and, in several instances, at reduced rates. PCI urges the inclusion of the strongest open competition provisions in any reform legislation.

The existence of regulatory rules that have not been codified or formally adopted—often referred to as "desk drawer rules"—is also particularly frustrating to insurers. PCI supports the elimination of

these inefficient and arbitrary obstacles to effective market operation.

Access to credible aggregate prospective loss data through required reporting by all insurers is essential for both small and large companies to ensure effective and competitive markets. PCI commends the chairman for reaffirming the McCarren-Ferguson Act, including the limited antitrust exemption for such loss-cost data.

We appreciate the chairman's efforts to pursue a coordinated system of standardized market conduct review based on market analysis to identify a pattern of abuse and on-site review of company systems and controls. PCI believes that market analysis must be the cornerstone of any market conduct action.

With respect to producer licensing, PCI urges the subcommittee to reduce regulatory burdens by providing a single level of licensing. Varying state standards for company licensing can serve as a market entry impediment and limit consumer choice. As a result, PCI supports efforts to streamline market entry.

With respect to enforcement, Mr. Chairman, there is no clear consensus among the property casualty industry on the appropriateness of a federal or NAIC supervisory or management role in insurance regulation. However, all agree that the greatest threat to efficient markets is dual or multiple layers of regulation.

Creating new oversight institutions or layers of reporting will drive up the cost of insurance products, make it harder for smaller companies to compete and ultimately reduce consumer choice. Attempts to unnecessarily expand the regulatory or oversight role of the NAIC or to create new or duplicative layers of quasi-regulatory authority at the federal level are almost certain to introduce needless controversy into any reform measure.

Mr. Chairman, PCI stands ready to work with the committee on State-based insurance reforms that achieve our shared goals, as fully outlined in our prepared statement, and avoid duplicative layers of regulation.

Thank you, sir.

[The prepared statement of Anthony Dickson can be found on page 107 in the appendix.]

Chairman BAKER. Thank you very much, sir.

Our next witness is a returning veteran witness: Mr. Robert Hunter, director of insurance for the Consumer Federation of America. Welcome, Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER, DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

Mr. HUNTER. Thank you, Mr. Chairman, Mr. Bachus. I am Bob Hunter. And I am the director of insurance for CFA. And I formerly served as federal insurance administrator under Presidents Ford and Carter and as Texas insurance commissioner.

Attached to my statement is a letter signed by over 80 groups, representing consumers, labor organizations, low-income Americans, housing groups and minorities, asking Chairman Oxley to reconsider the road map for legislation to override state regulation. The standards proposed in the road map are, in our view, startling in their anti-federalist sweep.

They do away with decades of deliberations by state legislators, largely eliminating their role in the future in preempted areas. The road map would override the vote of the people of California in adopting the regulatory system of Proposition 103 and regulators would become functionaries carrying out federal standards.

How Congress would force state compliance with these edicts without the threat of a federal takeover, which was also promised, is unclear to me. The road map does not tell us what the sticks or carrots might be to entice a commissioner to enforce a federal standard that he or she might think would disadvantage the consumers of the State.

The road map makes grievous error, we think, in overriding all state price controls. It ignores the differences between insurance and other products.

And serious attempt to increase competition in the insurance industry and protect consumers must take into account these differences. Some of the steps that must be taken to ensure that free markets could function well are first, a degree of imposed uniformity of insurance forms is required for consumers to understand and compare the complex legal document that is the insurance policy. People cannot read it and compare them. They just do not understand them.

Second, better information about policy prices, the level of service and financial soundness must be provided to consumers, as the NAIC also said in their written statement. Unlike other products, insurance has inelastic demand because states require auto insurance and lending institutions require property insurance of businesses and individuals.

If competition is to be effective, supply and demand must be balanced, perhaps by requiring limits on underwriting such as mandating offers of insurance to drivers who meet good driver qualifications and to home and business owners who meet building codes. The road map proposes none of these things to make competition work for the benefit of consumers.

It would leave consumers, including small businesses, vulnerable. And I have to remind you that, of the 5.7 million businesses in America, 3.4 million or 60 percent have fewer than five employees. And therefore, they are not sophisticated buyers of insurance with risk managers and so on. They really need help.

Other people who are at risk are low-and moderate-income consumers and minorities. The road map, I think, puts them at more risk.

A crucial aspect of rate regulation that the road map would eliminate is the approval of classifications, which is part of price regulation. Many states have moved to ban and limit the use of credit scoring, for example, or redlining by certain territorial definitions and control of other criteria that disadvantaged poor and minorities; the latest one being that we are going to charge you more if you previously bought the limit of liability required by the State, but did not buy higher limits, we are going to charge you more for that.

A lot of states are very upset about that. But who would stop that under the road map? These protections would be eliminated.

Insurers would also be free to imagine whatever classes they would choose, including intrusive classes, that are on the horizon, such as the use of the human genome for life insurance. Congress has already acted on health. But life insurance could be human genome-based.

And tracking drivers with global positioning satellite systems for auto insurance, that has already been tested.

The road map points to Illinois as a regulatory model. There are almost no states with fewer protections for consumers than Illinois.

Illinois does not regulate rates at all, under its non-system, as I am sure Mr. O'Connor will tell you. It is a non-system because the Illinois legislature did not pass it; they just became deadlocked and the existing legislation expired under sunset.

Since 1989, in Illinois, auto insurance rates have risen by 35 percent, greater than the national average of 30 percent, while California's rates, under the prior approval system put into effect by a vote of the citizens of the State, have fallen by eight percent. That is like 45 percent difference between California and Illinois.

Prior to modernizing its system, California had the same old, tired deregulatory system that the road map now proposes for all states. America deserves better than the weakest consumer protection. Americans deserve the best.

If you go forward with the road map, we would urge you to look at the nation's best system, California, as your model.

Under the road map, businesses would benefit from a single choice of law, probably the home state of the policy holder. But if a state tries to attract large corporations by weakening its laws, it could be to the detriment of its residents and consumers across the country.

You should also be made aware, as I have told you this before Mr. Chairman, that as you move on these areas—and I think it is good that you do move—but as you move, some good changes are occurring and some bad changes. Consumers support changes that get rid of unnecessary red tape like yellow pages and pink pages and all that. We do not like that either. We pay for it.

And we have helped work at the NAIC, with coming up with 30-day limits on how long it would take to approve policies and so on. We are for all that.

But we are very worried about harmful change. States do not always act because they think it is proper, because insurers are telling them the only way to keep their support, to head off a federal takeover, is to gut consumer protections. And that is dangerous. And we hope that the subcommittee would speak out against that sort of activity.

I have responded to your three questions in my printed testimony, Mr. Chairman. In a nutshell, CFA supports expanding the risk retention act to spur the creation of private alternatives to overpriced insurance that occurs in period hard markets.

We also offer a number of proposals to improve uniformity of regulation and protect consumers. The implementation of national standards should not be done in a way that stifles innovation of the States or undermines needed regulatory variation. Thus, CFA supports minimum national standards that would improve uniformity

and better protect consumers, while allowing states to exceed those minimum standards.

Some of the model bills proposed by NAIC and NCOIL would provide adequate minimum consumer protection at the national level, as I indicate in my testimony—things like getting rid of the final counter-signature law problems. We would support deregulation of property casualty rates for truly large commercial risks, as long as small-and medium-sized businesses were protected.

And we would consider endorsing the NCOIL market conduct model bill if and when NAIC adopts it and we then discuss together how to make sure that works well.

Finally, I analyzed the road map's concern with property casualty profitability and the fear of a collapse in my written statement. And I conclude there is no chance of that happening.

On behalf of the over 80 groups that signed the letter, I ask that this subcommittee not move forward with the ill-advised road map concept. CFA looks forward to working with the members of the subcommittee and with state regulators on proposals that will improve uniformity of regulation and speed to market without sacrificing consumer protections. Unfortunately, the road map does not achieve that balance.

Thank you, sir.

[The prepared statement of J. Robert Hunter can be found on page 116 in the appendix.]

Chairman BAKER. Thank you, Mr. Hunter.

Our next witness is Ms. Janice Ochenkowski. Did I pronounce that correct?

STATEMENT OF JANICE OCHENKOWSKI, VICE PRESIDENT EXTERNAL AFFAIRS, RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

Ms. OCHENKOWSKI. Absolutely.

Chairman BAKER. Thank you. Vice president, external affairs, Risk and Insurance Management Society, Incorporated. Welcome.

Ms. OCHENKOWSKI. Thank you. And good afternoon, Mr. Chairman, Mr. Bachus.

Mr. name is Janice Ochenkowski. And I am the vice president of external affairs for the Risk and Insurance Management Society, known as RIMS. It is the largest professional organization for the risk management community.

In addition, I am also a senior vice president responsible for risk management at Jones Lang LaSalle, which is a global commercial real estate company based in Chicago. And I have been working there for over 20 years.

I appreciate the opportunity to appear before you today on the issue of insurance choices for consumers. RIMS is in a unique position to participate in this hearing, as we represent commercial consumers of insurance that we have all heard about so much today.

RIMS members, which number over 4,000, support the advancement of efficient insurance purchasing abilities. RIMS membership spans the country and consists of entities of all different industries and sizes, including 84 percent of the Fortune 500 companies, but also 950 small businesses, which we define as those with fewer than 500 employees.

Nearly 2 years ago, RIMS spoke before this committee on the different insurance vehicles that are available to risk managers in their search to provide as much protection as possible for their companies' assets. We made a case for immediate and significant reform of the State insurance system.

RIMS also expressed its hope that one day an optional federal insurance charter would be made available for insurers operating in different states.

It is still RIMS' belief that an optional federal charter will streamline insurance purchasing for consumers and make the U.S. insurance system significantly more efficient. However, the reality is that some view an optional federal charter as too extreme a solution. And it seems to be an idea whose time has not yet come.

Chairman Oxley and Subcommittee Chairman Baker's proposals to reform state regulation are reasonable and attainable. And they will provide a much-needed opportunity for national uniformity and free market competition, without excess regulation.

RIMS fully supports the Oxley-Baker reform proposal and urges Congress to enact these reforms as soon as possible.

In this increasingly competitive marketplace, commercial insurance consumers like myself need choices, flexibility and speed. Operating throughout the country as the insurance buyer for Jones Lang LaSalle, I witness every day the numerous inefficiencies in the current state insurance system.

Insurance policies have pages of state regulatory language that do not really affect the consumer and do not provide protection. These inefficiencies must be addressed. And I applaud the members of this committee for presenting us with a meaningful blueprint for reform.

RIMS also recognizes the efforts of the NAIC in moving the U.S. system fully into the 21st century. The NAIC has made real strides in personal lines insurance reform. But much more needs to be done for commercial consumers.

You see, the NAIC can only develop model laws; it cannot force state legislatures to adopt them. And even when models are adopted, inevitably, changes are made, which results in 50 different approaches to the regulation of the industry.

The Oxley-Baker proposal offers a chance to bring the best of state regulation and federal oversight together in a way that will preserve the State's role, yet streamline and modernize the system for the benefit of the consumers.

I would like to address some areas of concern for RIMS and the risk management community, including market rates and forms and lead state concept for multistate companies. Several years ago, there was momentum at the NAIC to adopt a model law and regulation with respect to commercial lines and form deregulation. The NAIC adopted one short version of commercial lines regulation; however, a more comprehensive version has not been adopted.

A few states have no requirements at all for filing rates and forms for commercial lines of insurance. RIMS supports the Oxley-Baker principle that a uniform standard be adopted that provides for free market competition of rates and forms for commercial lines of insurance.

Our experience is that in a free, open and competitive market, risk managers will be able to negotiate the best rates, the best terms and conditions for coverage needed by our companies. RIMS believes that a national standard of freedom from form regulation should encompass surplus lines policies as well.

Currently, surplus lines policies and rate forms are not regulated by the States. However, we think it would be prudent to include freedom from rate and form regulation in any federal statute governing commercial property and casualty insurance.

My home state of Illinois has been cited frequently as a model for commercial lines modernization. In Illinois, the insurance market is strong and competitive. And insurance is widely available for consumers.

Some states have requirements that, before an insurance buyer can obtain insurance from a surplus line market, a diligent search of authorized insurers must be made to determine if insurance is available. We believe commercial consumers should be allowed to access the surplus lines market without having to make this determination.

RIMS recommends that legislation permit commercial consumers to purchase insurance from any eligible authorized insurer without making a diligent search of authorized insurers, as required by some state laws. Most RIMS member companies are entities like Jones Lang LaSalle that do business throughout the United States. In placing insurance, we as risk managers have to consider all of our exposures, no matter where they are located.

When we purchase insurance, however, we are subject to the individual state requirements with respect to our exposures in individual states, even if it is something as minor as a single vehicle that is a part of a large fleet program. RIMS supports the Oxley-Baker concept of a leading state regulator for commercial policies covering multistate exposures.

Under this concept, the State of the company's principal place of business would govern the insurance transaction, including the terms and conditions of the policy and the requirements that the producer be licensed.

Finally, I would like to address the issue of a federal enforcement mechanism to ensure state compliance with the proposed federal standards. The Oxley-Baker proposal calls for a federal coordinator with little or no real influence to work with the proposed federal-state advisory council.

RIMS supports the concept of a federal coordinator, but believes that for national uniformity to work, this individual should have some authority to determine that state laws comply with federal uniform standards. Obviously, this will be a sensitive area, yet one that must be addressed if these reforms are to be given a chance at producing national uniformity and free market competition without excess regulation.

RIMS looks forward to working with your committee and the Congress on these critical issues. Thank you for the opportunity to speak today. I appreciate your time, interest and leadership and welcome any questions.

[The prepared statement of Janice Ochenkowski can be found on page 161 in the appendix.]

Chairman BAKER. Thank you very much.

And our next witness is Mr. Phillip R. O'Connor with Constellation New Energy, Incorporated. Welcome, Mr. O'Connor.

STATEMENT OF PHILLIP O'CONNOR, CONSTELLATION NEW ENERGY, INC.

Mr. O'CONNOR. Mr. Chairman and members of the committee, thank you. I am Phillip R. O'Connor. I testified in June of 2001 to your subcommittee.

I should note I am not here on behalf of Constellation New Energy. That is my day job. I am really here, having been the director of the Illinois Department of Insurance at one time and as someone who has, over the past 20 years or so, conducted a lot of research in this area of comparing prior approval and open competition states.

First of all, just in terms of the general work of the committee, I think on the road map, its great merit is that you have managed, through the past couple of years of hearings and analyses, to separate out those issues and those areas where the States have made an enormous amount of progress the past 20 or 30 years—financial solvency, guarantee funds, a whole host of things—and on the other hand, areas where there remain quite a bit of lack of harmony, lack of uniformity and so forth.

And it seems to me that 60 years ago, in the same week that allied forces landed on Normandy and liberated Rome, the U.S. Supreme Court made the decision that insurance was interstate commerce. And this is really the first systematic review of how well the States have handled the delegation of regulatory authority that came in the wake of that decision.

And I think the committee deserves a great deal of credit for having taken that job on and for narrowing down the issues.

My job here, I think, is to talk just very quickly about the general distinctions or performance outcomes of those groups of states that are prior approval versus those groups of states that are competitive. The academic literature is really unanimous on at least one point; and that is you cannot find any systematic benefit from prior approval regulation.

Now people may be able to find some case study or some anomaly. And they may be able to point to some particular alleged benefit.

But when you compare the two systems, there is a long list of distinctions. So really, at best the finding can be that prior approval does no good; raising the question of: why is it that we do it? Why do we spend millions of dollars on it?

On the other hand, the general tendency of the academic literature is to point out that there is a variety of dimensions, upon which competitive states tend to perform better than prior approval states as a group. And I list those out in both this testimony today that I have filed and that in 2001.

But let me talk a bit about the Illinois system because it has received so much currency in the past couple of years. And I have to admit that sometimes when I hear my friend Bob Hunter talk about the Illinois system, I get the sense that my state has some evil twin out there that I am not familiar with.

The truth is, it is a system. Now Bob is right that it was an accident. But I would contend it is a happy accident. And leveling criticism at the Illinois system for having been an accident is a little bit like criticizing penicillin because it was accidentally discovered.

The point is it has worked—and it has worked extraordinarily well—the past 30 years.

Now let me identify the main elements of the Illinois system because indeed it does hang together quite well. The fundamental point is that the Illinois system has, in effect, opted for antitrust principles in insurance pricing so that insurers cannot agree or collude on their prices.

There are a variety of other things though where the State has stepped in to regulate very specific elements where the General Assembly believes that there is either potential for abuse or where they thought a particular problem had to be remedied.

Now it is true in work comp and in medical malpractice, we have competitive systems. But those are a bit different. They are like the competitive rating laws in other states where if there is a finding of non-competitiveness, there can be regulatory oversight.

The Illinois law prohibits unfair discrimination. You cannot base a rate on race, color, religion, national origin. You cannot reject an auto insurance application in the underwriting area solely by reason of a physical handicap.

And the Department of Insurance and the attorney general can pursue other unfair competitive practices related to rating that have not been specifically defined. But if they can demonstrate in court that these are unfair competitive practices, the State can step in.

For auto liability rates, a municipality cannot be subdivided for rating. That was to recognize the obvious point that in Chicago—a big city—we have one court system that applies to everybody. And therefore, liability is addressed on a unit basis there.

The General Assembly has targeted discounts in various public policy areas where there was a desire for some kind of promotion or recognition—auto anti-theft devices, senior citizen, driving training. Insurers can, through state licensed data collection agencies, mainly groups like the ISO and so forth, collect their loss data together. And they can do trended loss cost data on that.

But they cannot agree on final pricing. Only each group and insurance company have to set their own prices.

In auto and homeowner's, companies have to file with the insurance department illustrative rates so that consumers and the insurance department can take a look and get a feel for what is happening in the market. And they have to file non-renewal and new policy counts by zip code.

In addition, a cancellation and non-renewal information is filed by zip code in homeowner's, for instance, which is one of the tools we used back in the late 1970s to solve what was thought to be the residential insurance redlining problem. And we solved that back well over 20 years ago. And we did it through market mechanisms.

Our residual markets—yes, those rates indeed are prior approved. But they are prior approved on the basis that the director is going to avoid creating underpricing so that those residual markets act as a kind of magnet for too much market share. The FAIR

plan and the auto assigned risk pool have infinitesimally low populations. And the work comp pool, even in the hard market in 2003, had well under 10 percent of total premium.

My point to you is that the Illinois system, in reliance on the antitrust principles of no agreements on final pricing and no regulation of final pricing, is nonetheless able to target very specific areas where a public policy case has been made and the Illinois General Assembly decides to take action or where the General Assembly has given discretion to both the director of insurance and to the attorney general to take action.

One final point on California. The interesting thing in California is, in my view—and we can argue about this all day long—is that California inadvertently did in 1989 with insurance rates, freezing them at extraordinarily high levels that resulted from a peculiar set of circumstances, where that circumstance was in great part cured and the rates would have come down anyway.

They froze the rates at these very high levels and unfortunately repeated that mistake in the spring of 2001 when the State intervened in the electric market and went out and bought huge amounts of forward electricity at extraordinarily high prices; thus, freezing for consumers anomalous prices in a very short period of time.

But again, we could argue about that all day long. The point is the Illinois system has worked over 30 years extraordinarily well.

The Illinois General Assembly, whether under Republicans or Democrats, has never seen fit to pass out of either House legislation that would reverse that course.

[The prepared statement of Phillip R. O'Connor can be found on page 146 in the appendix.]

Chairman BAKER. Thank you very much. I appreciate each of your perspectives. It is very helpful.

I know, Mr. O'Connor and Mr. Hunter, we have a rather dramatic departure in the analysis of the data. And I can understand how that analysis can differ.

The one thing I would be interested to know from either or both, with regard to levels of consumer complaints, I often want to know from a company, for investment purposes, what the customer satisfaction surveys look like. If people are buying their TV sets and they are bringing them all back in 30 days for a full refund and if you knew that, you would probably have a pretty good outlook about where that company was going over the next quarter.

I think equally valuable from a regulatory perspective is how many people write letters, show up with complaints, file actions and what the history in Illinois versus California might be. If the system is working in the competitive market as well as I think it is and if the California model is convoluted and unreasonably constrained, those numbers ought to be reflective of that analysis.

Do either of you happen to have any access to information of that sort or numbers that might help build a case one way or the other?

Mr. O'Connor?

Mr. O'CONNOR. Well, I do not have them on hand. However, I would point out that both Illinois and the California Insurance Departments operate fairly similar policyholder and consumer complaint systems.

I believe Illinois and I believe California publishes the ratios. And I believe there is a classification system in Illinois where there is an effort to identify, generally speaking, what the complaints are about.

During my period of time when we initiated those systems, generally speaking, price was not the thing people complained about, nor availability. It was usually issues about claims and that kind of thing.

One of the terrific things in Illinois—and this has been true for a long time—is that because of the system of pricing, it is extraordinarily easy for a consumer to shop right through the yellow pages and get indicative quotes over the phone from any number of agents or insurance companies. And that has been something that I think has been recognized in any number of reviews of the Illinois system.

But the Illinois Department of Insurance, I think, is perfectly able—as are other states—to provide the information that would answer your question.

Chairman BAKER. Thank you.

Mr. Hunter?

Mr. HUNTER. ON the NAIC website now, because we pushed for it for years and they finally have adopted it—is something called a consumer information source that has the data by countrywide, by state, broken out by company, all different ways you can look at it. It has been my experience that what drives complaints more is the individual company than where they are. It is corporate culture.

For example, on my right here is New Jersey Manufacturers. Their complaint ratio is almost nonexistent. They are a very excellent company.

They come in with low rates. If I lived in New Jersey, I would be dying to be one of their insureds. They have very few complaints.

Chairman BAKER. Mr. Dickson ought to be paying you for that. [Laughter.]

Mr. HUNTER. Same true for USAA, for example. And it does not matter whether they are in a regulated or a non-regulated environment, they always have great results.

New Jersey Manufacturers is an example of a great company does great even under tremendous regulatory constraints. And so I would say you could go on the NAIC website and get that information. I did not have that question or I would have done it for you.

But if you go on www.NAIC.org and look for the consumer information source, you can get that data.

Chairman BAKER. But could I conclude from your observation that if we had a non-regulated file a new system and you had good companies, consumer complaints would remain low? Or is it your allegation that if you go to that system, that is going to automatically trigger anti-consumerism activities?

Mr. HUNTER. I do not know that it matters a tremendous amount. A lot of the complaints have to do with claims. That is not going to change based on the type of regulation you have upfront, although better market conduct might cut those number of claims.

So that is one of the reasons we have supported here possibly federal involvement in some market conduct areas.

Chairman BAKER. Thank you.

Mr. Singer, from your perspective from a Massachusetts view, what do you attribute the loss of auto insurance providers in any—the numbers of folks who are leaving? What is it that causes them to assess the marketplace environment and withdraw from providing that coverage any longer?

Mr. SINGER. Mr. Chairman, I think the reason that today there are only 20 insurance companies writing automobile insurance in Massachusetts, as opposed to over 250 in Illinois, is because the very, very rigid rate control has driven capital away. Companies do not want to expose their capital to what they see as—what is—a very restrictive rate control regime that at times makes it unable for them to earn a profit. And they do not want to expose their capital to that.

The result is, with so little capital available in the market, I think the impact is that rates are higher than they would be otherwise if there were more competitors. It has impacts in other markets too because we do not have personal lines, auto carriers, those large personal lines companies do not write homeowner's in the State. So it has an iterative effect on other coverages also.

Chairman BAKER. Thank you.

Mr. Counselman, you may not have this information readily available. It appears, at least from a non-expert view looking in, that states imposing price controls on auto insurance seem to have more of their consumer base in the residual marketplace than states with a free market pricing system. Can you speak to that?

Mr. COUNSELMAN. Mr. Chairman, you are correct. I do not have figures with me. But from experience—and we do write insurance and the council's members write insurance throughout the United States—that where there are price controls, our experience has been there is less availability of market because fewer companies are willing to operate in that given state under those circumstances.

We know, for the last number of years, commercial insurance companies and personal insurance companies have had serious profitability problems. And they have looked at where they feel they had the best opportunity to be successful and where they had the least opportunity to be successful.

And more often than not, it is in the regulated, price controlled areas they choose to exit. So there is less market available. So for those of us who are agents and brokers, we find ourselves with fewer solutions for our customers in a price controlled environment.

Chairman BAKER. Yes, Mr. Dickson?

Mr. DICKSON. Thank you, Mr. Chairman. I just wanted to amplify a bit on my neighbor's remarks here. When companies are not present in a marketplace, it causes tremendous strains on those of us who remain to try to provide a market.

New Jersey, over the years, has been an example of that. We are committed to that state. But we cannot do it alone.

We cannot be the last lifeboat in the water. There has to be a competitive marketplace. We need help. We cannot see our resources strained so that the service to our policyholders suffers.

Chairman BAKER. Thank you. My time has expired. But I will be back.

Mr. Kanjorski?

Mr. KANJORSKI. Thank you, Mr. Chairman.

Maybe I will start with this first question. As you see the conceptual outline that is presently being floated, Mr. Hunter, what do you think the effect would be on a small business, if you have any?

Mr. HUNTER. I think it would be very dangerous for small businesses because the same kinds of problems that impact individuals impact those very small businesses. The artisan truck and so on has to go buy auto insurance for its truck.

It has to go buy property insurance for its place of business, if it has one. It has to buy comp insurance for its employees.

They need help. They do not understand the complex product any more than the person on the street. They do not have risk managers helping them.

They are not sophisticated buyers of insurance. And therefore, they are subject to all of the same kinds of classification games or being misled into taking the wrong product. They need the same kinds of protections. We think the road map would eliminate them.

Mr. KANJORSKI. You were in the hearing room during the other panel. And I am not sure if I could distill exactly what the panel's testimony was. But I seemed to understand, for Mr. Csiszar at least, that there would be some movement in this compact situation by 2008, particularly since the Congress is giving some impetus now by even considering doing something.

But what if we were to change that perspective and instead of going with the present conceptual outline that we lay down a dual course, establish a commission to study the federalization of insurance at different levels or with different industry—the charge to prepare an optional federal charter, say for the life insurance industry, as a starter—and then giving them a drop-dead date, 2007 or 2006. Either the compact is complete and in operation and effectively on its road to solving the problem so we do not have to take federal jurisdiction, or a kick-in that at least we would establish an optional federal charter for life insurance.

And the question that I really have for you from a consumer's perspective: how detrimental or how advantageous would an optional federal charter be for consumers?

Mr. HUNTER. Obviously, the devil is in the details, we have heard several times today.

Life insurance is not a simple situation. I think life insurance has a much different picture than the property casualty insurance industry. And I think the property casualty insurance industry is a millstone around the life insurance industry's neck in terms of getting federal relief.

The life insurance industry is much more uniform across the country, much more subject to having a workable federal charter. We do not like optional charters because we think that it produces the rates to the bottom.

But if you did a federal minimum standards or a federal takeover with decent consumer protections, we could consider that. But we do point out, there are differences between life insurance products that are very important to consider.

One would be, for example, term life insurance, I think you could totally deregulate. And people understand term life insurance and so on.

You get into some of the cash value products, people are very confused. They need help. They need information. It is a very difficult product.

The third product I would cite would be credit life insurance, where you have a reverse competition driving the rates up. States have had to cap those rates. You have to have some kind of a control on the rate in that area.

So they have three totally different products within the life insurance industry that would have to be dealt with in any bill that you might propose. But otherwise, I do not like the optional charter. But I do understand that life insurance has different needs.

If you divorce life insurance from property casualty, I think we could talk. I am a little worried about setting up something that would cause the race to the bottom. But if we do the consumer protections and do that somehow, then I think we would have something we could talk about, yes.

Mr. KANJORSKI. Well, I am just rolling in my mind the idea that we would use this triggering mechanism to drive the process now. If I remember, we were here about 5 years ago when the national insurance commissioners were telling us that they would have everything solved by now.

And here we are. And they moved the goalposts off another 4 years.

Mr. HUNTER. I would defer to Mr. Pomeroy, who was president of the NAIC. I think he is right. I think it is very hard to get legislators to pass all those things.

I think he is correct. I think getting a national basis would be pretty hard to do. And I do think that they need some kind of federal help.

Mr. KANJORSKI. Did anyone else on the panel have any idea of what I am talking about, this triggering mechanism to run concurrently with what the plans are by the State commissioners now? That if they do not adhere to a certain time schedule or get an accomplishment, it kicks in. But in the meantime, we get a commission working and studying how we would implement a federal charter, particularly life insurance?

Mr. COUNSELMAN. Congressman?

Mr. KANJORSKI. Yes?

Mr. COUNSELMAN. I would like to comment on that. Also from the standpoint of the small business owner, the small business owner is at a disadvantage in the market where it is difficult to obtain insurance, obviously. And one of the things that we experience with the small business owner is it is a competitive market if you are doing something that is very standard.

There are many insurance companies—large ones and small ones—wanting to write insurance for small business owners. But if you are doing something that is not so ordinary and standard—let's say software developers, for example, but there are many examples—then it is more difficult to get insurance. And then there needs to be a mechanism to respond to those specific needs.

One of the issues is in that particular niche, there may only be 500 or 1,000 or 5,000 of them total in the United States, scattered in different states. And they need a mechanism to respond to their insurance need.

It is not practical for a huge insurance company that is writing a multitude of risks to decide that they will file a special program just to satisfy a few hundred or a few thousand insureds. And so they do not. They do not respond to that need.

If they had a mechanism that they could respond to that specific need—and that might be a federal charter, for example—then that small business owner has an opportunity to buy insurance that they otherwise would not have. So that is why I would comment that a dual look at that, at the federal issue, the federal charter issue, while not eliminating what is going on in the States, can make a lot of sense and actually can protect a lot of small business owners who currently are not getting what they need.

Mr. KANJORSKI. Yes?

Mr. AHART. Just a quick comment. I am not sure why you would wait to see, like in 2007 or 2008, whether something was working or not. Under the current road map, it seems that life insurance is really no different than property and casualty and that what they need is uniformity for products, uniformity for licensing.

And that can be done through the road map by having federal legislation target that specific area which can give the uniformity that it needs through the States, therefore preempting the States on those issues. And you could get results right away, rather than waiting to see if something is happening in 2007, 2008 and then at that time doing something.

Mr. KANJORSKI. Well, I am not suggesting not doing something. But as I gather these conceptual things, there are not any triggering mechanisms or actual standards or federal charters that would be put into place. It would be merely keeping a coordinated view, advisory view of what is happening.

And my own sense is that it is not going to move many people to really get down and dirty and decide to do something about the corrective mechanism. So what I am thinking about is to build right into it; that as we are monitoring, we establish a commission to report back to the Congress with some ideal legislation that we could pass at a given time, or in fact would be enacted if not passed.

It would make it actionable within 30, 60, 90 days of the report so we could move right into the thing. But give the States this opportunity of a couple of years, but not indefinitely.

If we wait until 2008, they are going to come back and say, "Well, we have 45 members of the compact. We are still working on five." Then we are back to 4 years.

It is going to take us 2, 3, 4 years to move into this area, it would seem to me. So we probably should look at doing it.

But I appreciate your responses, gentlemen.

Chairman BAKER. Thank you, Mr. Kanjorski.

Mr. Bachus?

Mr. KANJORSKI.—and ladies.

Mr. BACHUS. Thank you, Chairman Baker. Chairman Baker's staff did some research on this, how long we have been waiting for

uniformity. And at one of our very first insurance reform hearings—this was 3 years ago—Michigan Insurance Commissioner Fitzgerald stated that "uniformity or a very high level of standardization, I think is the goal, not only of the commissioners, but certainly of the industry and would benefit the consumers of this country."

Chairman Oxley then asked both Commissioner Fitzgerald and Ohio Commissioner Covington the question: "If Congress sets a goal of 3 to 4 years for achieving comprehensive uniformity by NAIC for product approval, do you and Mr. Fitzgerald feel confident you can meet that goal?"

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

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

So I mean, I think that may give you an answer of what may happen in 2008. And I know that Chairman Oxley—I mean, Chairman Baker—has waited 2 or 3 years.

He has held 14 hearings. He has heard from over 100 witnesses. And yet, the unanimous opinion appears to be that NAIC has still not achieved significant uniformity, although everybody agrees it needed to be done 3 years ago and it could probably be done in 3 years.

So that is just a bit of encouraging news.

[Laughter.]

But I think that may tell you why——

Chairman BAKER. Do not bring me a problem, would you please.

[Laughter.]

Mr. BACHUS. And you are still being urged—Chairman Baker is still being urged to be very cautious and go slow because we are on schedule.

Let me direct this question to Mr. Ahart. Could you explain how congressional passage of targeted federal legislation that improves the core aspects of state insurance regulation would benefit your agency and consumers?

Mr. AHART. Sure. It really would get to the speed to market issues, which pretty much would be the licensing issues for both companies and agencies and also the issues on new products and on price controls. And first of all, on the licensing issues, as I mentioned in my testimony, we have more and more consumers all the time, personal lines that are buying homes in another state or on businesses that are opening branches in other states.

And even though their home base is where we are in our state—New Jersey—we still are required to be licensed in those states to be able to handle all their needs. And they do not want to be dealing with different agents in every state that they operate in.

And so as they expand—and it is so easy to expand anymore with technology—as they expand, we need to be licensed in those states. Even businesses with worker's comp, they have people that

travel that technically can bring suit in some of those other states or be hired in those states.

We need to be licensed in those states to take care of them so we would be able to provide the protection the consumers need. And it would certainly help the agency keep those consumers.

As far as the product development and the rate controls, again New Jersey is a great example. As more restrictions we have, availability is down.

And the competition is down. And pricing goes up. And our residual market goes up.

And as Congress, under this road map approach could take those specific issues and pass legislation just to address those issues and yet keep consumer protections under state regulation and things like that. So it is not doing everything. It is keeping the good stuff with the State and attacking those specific problems that need it.

Mr. BACHUS. Okay. Thank you.

Mr. Counselman, you testified about the success of NARAB. Do you think replicating that success in the area of speed to market reforms would be possible without legislative action or congressional action?

Mr. COUNSELMAN. Congressman, I think congressional action would be necessary because I think there has to be an outside impetus for states to cooperate and feel it necessary to pass the required amendments to their laws. And I think NARAB proved that that formula works because there was a specific goal set out and the States knew that they needed to accomplish that.

They have still not accomplished it in 50 states. They only had to achieve it in 29 states. And some of the largest states still have not complied in all aspects of NARAB by passing uniformity.

So even NARAB can be improved upon. But I think in speed to market and the ability to file forms, the same sort of carrot and stick relationship can be developed with the States so that we actually can make use of what the States have already established and encourage them to improve that. And that is good for the consumer.

Mr. BACHUS. Okay. Thank you.

Mr. Baker, I would just like to maybe mention, I do not know if it is a question, but I did hear two things that the panel said, one of which I would just maybe like a clarification on, and that is from Mr. Singer.

You talked about eliminating review and approval of forms for commercial lines. You sort of focused on that, not personal lines, whether I guess it is at the State level or the federal level.

But is it not equally important for personal lines for consumers to benefit? I mean, is there any valid reason for the distinction? Or are you not saying it is not necessary for individual lines?

Mr. SINGER. Congressman, I guess what I would say is that commercial line businesses, even small businesses, are more capable, I would think——

Mr. BACHUS. The sophisticated buyer type?

Mr. SINGER. And we sell a lot of small business products. And we try to make that product very easy to understand. We have to sell it on price.

We have to sell it on understandability. We have to web-enable it so the agent and the customer can see it very easily.

I think there is much less justification in that context—in a business context—to require all the process that is necessary for rate and form approval. It slows up delivery of the product to the customer.

Mr. BACHUS. Would you agree that consumers would also benefit greatly from access to product without delay too?

Mr. SINGER. I think in every case where you can reduce the process, what I really testified about was the going through the lengthy process in 50 different states to bring a product to market.

Mr. BACHUS. Yeah, and that is in commercial lines. But the same problems in personal lines would——

Mr. SINGER. Yes. Same problem.

Mr. BACHUS. Okay.

Mr. DICKSON. We would certainly agree. PCI recognizes that the Illinois model is one that has worked. It would help availability in personal lines all across the country and particularly in some difficult states such as we have experienced in the past in our own state of New Jersey.

Mr. BACHUS. Okay.

And Mr. Hunter, I know you are going to respond. Let me ask you this.

Mr. HUNTER. Okay.

Mr. BACHUS. As you are responding to that—and I will close with this—you made the Statement that minorities are disadvantaged by the use of credit scores.

Mr. HUNTER. Yes.

Mr. BACHUS. How about an individual who is a minority that has a good credit score? Is that sort of stereotyping? I mean, does that assume——

Mr. HUNTER. No, there is research that shows that there is a disparate impact on minorities of the use of credit scores in insurance. Missouri has just published it. The State of Maryland did too.

Mr. BACHUS. But how about a member of a minority that has a good credit score?

Mr. HUNTER. They would probably get a break. But the problem is, many minorities are impacted adversely by the use of credit scores.

And credit scores, there is no basis for it. There is no thesis. All they have is a correlation. There is no argument.

I have debated Fair Isaac and Allstate and all these people. No one can tell me why, if I am laid off because of the bad economy and it takes me 9 months to get my job back and I fall behind on a couple of bills because of that, why I am a worse driver next year or a worse homeowner. It just is not true.

And they say, "Well, we have a correlation." Well, California Department of Motor Vehicles found a correlation between hair color and driving record.

Mr. BACHUS. I guess what I am saying, are you saying that insurance companies, if they get a credit score from a person and he happens to be a minority and he has a good credit score, that they would use, that they would——?

Mr. HUNTER. They get a better break on the basis of a credit score——

Mr. BACHUS. But it is not because of the color of their skin?

Mr. HUNTER. Yeah, but minorities are way more adversely impacted, according to the studies. Plus CFA's very careful analysis of credit scoring shows that it is a horrible situation of error. The credit scores are just dead wrong.

We looked at 500,000 credit scores. And we found that around just the prime, sub-prime lending number of 620, 20 percent of America was misclassified. I mean, there are just so many errors. It is just a very bad system.

Mr. BACHUS. You are aware, you know we passed legislation overwhelming which ought to help address that and let people repair their—in fact, I think you all supported that.

Mr. HUNTER. We did. And we appreciate that.

Chairman BAKER. Thank you, Mr. Bachus.

Mr. HUNTER. But I do want to comment though, I agree with the NAIC on the personal lines question. The NAIC's testimony today states this: "Based on many years of effort, we do not believe a single national rating or product regulation model for personal property casualty lines is appropriate or feasible, whether imposed by the States or the federal government." And I agree with that.

Chairman BAKER. Okay.

Mr. Frank?

Mr. FRANK. I have one important question that I had not intended to ask. But I cannot leave here still wondering. Which hair color are the bad drivers?

[Laughter.]

Mr. HUNTER. Gray.

[Laughter.]

No, actually darker is worse. And it may be correlated——

Mr. FRANK. That is a pro-blond statement then.

Mr. HUNTER. Yeah, pro-blond.

Mr. FRANK. That would be welcome, the anti-stereotype thing.

I noted—and I apologize for not being able to be here earlier, but I did read through the testimony—a clear statement of disappointment with, almost exasperation with the States' record here—that they have taken too long. There was a reference to difficult states.

And apparently the general sense here is that the insurance industry lobbied very successfully in the 1940s to have this industry be a state regulated industry and now is telling us, from the representatives here and others I have heard from, that they are unhappy with the States, that the States are not doing a very good job.

Is it incompetence? Are they not trying? Why have the States so disappointed with this? Why the need for a fairly drastic change in the federal-state relationship?

Yes, sir?

Mr. AHART. Yeah, congressman, I think first of all, they are still doing a very good job for the most part of it. The problem is, with changes in our society—with new technology, the modernization and globalization.

People are moving. It is easier for people to operate in more than one state. And therefore, it brings into play the need for uniformity, rather than just dealing with——

Mr. FRANK. It is solely because people operate in more than one state?

Mr. AHART. What is that? I am sorry.

Mr. FRANK. This is solely a problem of multistate operations.

Mr. AHART. I think it is a problem of uniformity.

Mr. FRANK. Well, no. But uniformity is a response. That is not the problem.

I have to tell you, with regard to uniformity, do not be surprised at a lack of uniformity from what were intended to be 50 separate decision making entities. I mean, indeed, uniformity is at one end of the pole. Federalism is at the other.

And I have to say, as I have been listening to this committee's work more closely in the last year since my job changed, about all aspects of it than before, I am struck by this pattern that we hear. And this may be a fundamental change in America, with regard to even the business community.

We hear it with regard to the Office of Comptroller of the Currency needing to reemphasize his preemptive powers. We had it last year with the emphasis on preemption. Some people wanted to go even further in credit scoring.

Now the insurance industry really is asking us to begin the process of reversing a decision it initiated 60 years ago with regard to where the focus is. I mean, have we reached a point where, because of technology and other factors, the States are not to be given much economic power?

You know, after the Supreme Court's redistricting decision, Everett Dirksen said—inaccurately at the time—"pretty soon the only people who will care about States is Rand McNally."

[Laughter.]

I mean, it does sound to me like, from the economic standpoint, that is what we are talking about—no uniformity and they are difficult and they are not making good decisions. So maybe we ought to look. Because we do not want to just do it piecemeal.

Is this in fact part of a general view that the States have become increasingly irrelevant economic decisionmakers?

Mr. COUNSELMAN. Congressman, if I may?

There is a fundamental change in our business—especially in the last 10 years, but it has been going on for 20 years—and that is what Mr. Ahart was talking about. Our businesses that we insure, our customers, they are operating throughout the country or in different parts of the country.

And it used to be that they operated primarily in one location, except for a handful of Fortune 500 companies. But now everybody, even the small guy, is operating——

Mr. FRANK. Okay, well that helps me. So if it is that thing, but that would deal with most business, but would not affect residential property though and even, to a great extent, to private automobiles.

I mean, if it is a question about sort of accommodating the multistate operations, that is one thing. But there are clearly a lot of things in the property and casualty business in particular and

also in life insurance. I mean, people are who they are. And I do not understand what globally has changed about a certain individual who bought life insurance.

Yes, sir?

Mr. DICKSON. Thank you, congressman. I think there are several themes that you have heard today. There is a desire for efficiency.

Mr. FRANK. No, I am not asking. I understand what you want. But I am trying to get at why you want it.

Mr. DICKSON. Well, I think in part there is a recognition on the part of the industry, a significant frustration on the part of the industry, that in a number of states, there has been a failure to recognize——

Mr. FRANK. No, I understand that. Excuse me. You have said that. I understand that. I have heard that.

I am asking: why do you think the States have done the things that frustrate you? I am trying to understand.

Is it bad governance on the part of the States? Are they not able to do this? Is this too hard for them? Or have they been having changes?

You need not restate the problem. I understand what you think the problem is. But you cannot solve a problem unless you understand why it is there.

Mr. DICKSON. Well, they are not using market-oriented regulation or competitive factors.

Mr. FRANK. Why not?

Mr. DICKSON. Perhaps because there are other less objective considerations that the political system dictates.

Mr. FRANK. Okay. See that, I think, weakens your case. In other words, you do not like the political outcomes in the States. Frankly, I do not always either.

You know, I was not dancing in the streets yesterday with my own state. I would have voted against that amendment.

But that is what federalism is. And you cannot cherry pick it. And I appreciate your honesty in this. You do not like the political decisions in the States.

But then let's be honest about that and say: what do we do about that? You cannot give people the right to make only correct decisions. And if states, you say they are not using good political judgment, I think we ought to be very careful before we decide that we are the federal appeals court for bad political judgment at the State level.

Mr. Hunter?

Mr. HUNTER. Yeah, I was just going to say when I was first briefed on the first optional federal charter bill by the industry proponents, I asked the question: how come, for the last 25 years, when the consumer groups have been yelling that state regulation is inefficient and ineffective, you guys did nothing to help us? And their answer was: Gramm-Leach-Bliley has changed everything.

We did not care when it was inefficient before. We controlled it. We liked it.

But now, it is different because now we are competing more directly with the banks. And I think that was a very honest answer.

And the insurance industry historically has been for federal regulation at times and for state regulation at times. Wherever the lais-

sez faire was the laziest, they were for that. They lost lawsuits back in the Supreme Court trying——

Mr. FRANK. By the way, I think it is entirely legitimate to say, "Look, sometimes we want to go federal and sometimes we want to go state, depending on the outcome." That is what most people—most people here prefer that issues be decided at that level of government where they are likeliest to agree with the outcome.

But then we should all stop pretending that we are either for states' rights or not for states' rights. And there is no moral imperative in that it be done one way or the other.

Two other quick questions because I noticed, I very much agreed with the Statement of Ms. Ochenkowski about this. And I think there is a real hole in this that has to be filled.

You support the concept of a federal coordinator, but believe that for national uniformity to work, this individual should have some authority. This will be a sensitive area, yet one that must be addressed.

I mean that, it seems to me, is sort of the sine quo non. It does not make sense to take some power away from the States and create this move and have nobody to run it.

And until and unless we can come up with that, I think we have a very serious problem here because, in fact, if it does not work in the State by state thing, giving it more power and less ability to make a decision could make things worse, rather than better.

Let me just throw on one other thing and I would be interested in comments on this mechanism; and that is, I have to say, I mentioned Massachusetts. I have not been in the Massachusetts Legislature for a long time and I do not plan to go back, but——

[Laughter.]

——tell me again that they cannot do the way they do rate regulation. I find that very hard to justify, for my state or any other.

And we are not here talking obviously about globalization. We are not talking about multistate operations when we talk about automobile insurance rate setting. We are talking about a political judgment that people disagree with.

And I may or may not disagree with it. But I do not understand, in our system, how we just cancel it out.

So I think that one, just saying to the States, "You are wrong, stupid. And we know better. And you cannot do that anymore," is a very hard sell in our system.

But now let me get back, people, in closing, I would be interested: where are we on the question of a mechanism? And do you agree that we have to have a less ambiguous mechanism if we are going to expect this thing to function?

Anybody?

Mr. COUNSELMAN. I will respond to that. I think we need to say what needs to happen.

Mr. FRANK. Who is we?

Mr. COUNSELMAN. I think Congress——

Mr. FRANK. Okay.

Mr. COUNSELMAN.——I think needs to say what needs to be done because the commissioner of Massachusetts or the commissioner of New Jersey, he does not have to be concerned about what is going

on elsewhere in the country. He is concerned about what is going on in——

Mr. FRANK. But how do we enforce that? I understand that. But my problem is I do not—I mean, the goal setting, I tend to agree with mending the goals, not overriding the regulation. But the enforcement mechanism, I am afraid without an enforcement mechanism, we may just be adding to the confusion.

Mr. COUNSELMAN. Well, perhaps our mechanism needs to have something that we would do, some action that the federal administrator would be able to take if, in fact, the standards were not met by a given date.

Mr. FRANK. Yes, I would advise you to work on that because I think that, again, is what you need.

Anybody else? Yes, sir?

Mr. SINGER. Well, congressman, a simple solution would just be a preemption of rate setting. I mean, there is a reason that——

Mr. FRANK. Only that and nothing else? None of the other——

Mr. SINGER. No, but that would be a solution to the Massachusetts and New Jersey problem. And I think the politicians and the administrators in Massachusetts and New Jersey do a very, very good job on most things they do.

Mr. FRANK. But you just disagree with their value decision? And you want us to cancel it.

Mr. SINGER. What I think is they have forced themselves into a position where there is so much political risk in letting the steam out of the rate system that they cannot do that.

Mr. FRANK. By political risk, you mean public reaction?

Mr. SINGER. Public reaction——

Mr. FRANK. So it is not the politicians we should overrule, it is the public.

Mr. SINGER. I think in fact the public would not be hurt. I think ultimately——

Mr. FRANK. Do you think the politicians do not understand what the voters would do? I mean, you said the politicians will not do it because they are afraid of voter reaction.

I have to tell you, one thing about Massachusetts politicians, please do not suggest that they misunderstand voter reaction. They tend to be very good at that.

Mr. SINGER. Yes.

Mr. FRANK. I do not think you understand. But is that not your problem? I do not want to play games with you. What you are basically saying is there is a decision made by the electoral forces in Massachusetts with which you disagree. And Congress ought to cancel it.

And that is a hard sell for me.

Mr. SINGER. I think the political mechanism in Massachusetts, unfortunately, has itself into a very difficult problem.

Mr. FRANK. But you realize that political mechanism is called democracy?

Mr. SINGER. Yes, I understand that. I understand that. But I also understand that some economic decisions sometimes are made at different levels of government. And I think simply it is not working now.

We are strangling an economic market to the disadvantage of consumers in Massachusetts.

Mr. FRANK. And the consumers are too dumb to understand to understand that?

Mr. SINGER. The consumers have no choice. There is only one——

Mr. FRANK. No, they have a choice politically. They have a choice.

What you said is the consumer reaction to doing away with regulation intimidates the politicians into keeping it, so the consumers are forcing the politicians to do something which is bad for the consumers. Consumers are the voters, after all.

Mr. SINGER. And the consumers and the voters probably will change it at some point.

Mr. FRANK. I am afraid you are going to have to wait for them. I am not going to short circuit the democratic process with regard to my state or any other in that regard.

Mr. SINGER. I understand.

Mr. FRANK. Thank you, Mr. Chairman.

Chairman BAKER. The gentleman yields back his time.

I do have follow-ups, which I will provide in writing to each of you at a subsequent time, as I am sure other members may as well. I just want to thank each of you for your participation. This has been a helpful step in our work. And we look forward to our continued conversation.

Our meeting is adjourned.

[Whereupon, at 2:05 p.m., the subcommittee was adjourned.]

A P P E N D I X

March 31, 2004

Opening Statement

Chairman Michael G. Oxley

Financial Services Committee

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"Working with State Regulators to Increase Insurance Choices for Consumers"
Wednesday, March 31, 2004

Let me begin by thanking Subcommittee Chairman Richard Baker and Oversight and Investigations Subcommittee Chairman Sue Kelly for holding between them 14 hearings and roundtables over the last three years on the need for insurance reform. Your hard work and Chairman Baker's commitment to increasing competition and effective oversight for insurance consumers created the foundation we are building on today.

In addition, I want to recognize one of the real leaders of our time, our first witness and President of the NAIC, Ernie Csiszar. President Csiszar has served with bipartisan distinction for both Democrat and Republican governors in South Carolina, and has worked closely with our Committee in forging some central goals and concepts for improving insurance regulation.

Too often the legislative process gets bogged down in turf protection, partisanship, and political conflict avoidance. Rare is the leader who can overcome self-interest and the status-quo, and help create the opportunity for change to achieve a greater good.

I also want to thank New York commissioner Greg Serio and past NAIC President Mike Pickens who have also been of enormous assistance in working together to build the foundation for a consensus middle ground approach to reforming insurance regulation. All three leaders have been steadfast advocates of retaining the strengths of state-based insurance oversight, and have helped us think through alternatives to Federal regulation as we forge a path towards uniformity. I also want to recognize and thank Mike Kreidler, the insurance commissioner from Washington.

Achieving uniformity will not be easy. At the first meeting of the NAIC, the New York insurance commissioner and founder of the NAIC, George W. Miller, stated, "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, not retaliatory, but uniform." That was in 1871, six years after the Civil War ended.

Since then, the NAIC has testified before this Committee and its predecessors numerous times that we are almost there, that new programs have been developed,

new models agreed to, and in just a few more years we'll be closer to the elusive goal of uniformity promised back 133 years ago.

As a former State legislator and member of NCOIL, I have been one of the strongest proponents of the NAIC and its efforts. But as we have demonstrated throughout the 14 hearings in this Committee over the past three years and the numerous hearings held previously in the old Commerce and Banking Committees, the States cannot get the job done by themselves. The collective action barrier to getting 56 State legislatures and regulators to act in complete unison is, and will always be, insurmountable, absent Congressional legislation.

Representatives Sue Kelly, Richard Baker, other senior Members of this Committee and I worked together during Gramm-Leach-Bliley legislation to establish what is now referred to as NARAB -- a targeted State-based reform proposal enacted into law that required a majority of States to adopt reciprocal or uniform licensing regulations. NARAB has been an enormous success, and all but a handful of States have met the goal. Agents can now become licensed and sell insurance to their customers nationwide generally within one to three months with greatly reduced red tape and costs.

In contrast, company licensing takes a majority of the States over six months to review, with 17 percent of the States according to one study requiring more than two years to complete their reviews. While the NAIC has tried to create a uniform application form and coordinated process for company licensing, without a Congressional mandate, the effort suffers from incomplete participation, numerous deviations, and unenforced deadlines. We can do better. The success of NARAB can be a model for bringing the States closer to fulfilling their own goals.

After three years and 14 hearings we need to move from oversight to building legislation. But we are just beginning this process. Subcommittee Chairman Baker and I have offered some goals and general concepts for reform, but these are intended to be a starting point for discussion.

We want to strongly encourage Members on both sides of the aisle and our witnesses here today to fully participate and provide input in this early stage of working through a legislative approach. It won't be easy, and we have a few issues, such as the role of a State-Federal partnership to coordinate uniform insurance policy that still need to be worked out.

But we have the opportunity, like President Csiszar and Commissioner Serio, to demonstrate a commitment to leadership and accomplish something meaningful and lasting for consumers. I hope that you will all join us in this effort, so we won't have to wait another 133 years.

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Congressman Vito Fosella
Opening Statement
March 31, 2004
Subcommittee on Capital Markets, Insurance and Government Sponsored Entities
Working with State Regulators to Increase Insurance Choices for Consumers

Mr. Chairman,

First let me thank Chairman Oxley and Subcommittee Chairman Baker for their efforts to assemble a proposal that will modernize the insurance industry. I also want to thank everyone for coming in today, and give a special thanks to Superintendent Serio for his leadership on this subject. He has served New York well and we appreciate everything he is doing to reform the insurance market in my home state. In addition, I would like to thank Ms. Ochenkowski for her willingness to come down today and help the committee move forward with it's comprehensive reforms.

I don't have to remind anyone here how important the insurance industry is to this country. For most, insurance provides the first layers of security for families and individuals when tragedy strikes. And while all of us hope that we never have a need to exercise our policy, it is necessary for most American's to have the security of knowing they'll still be able to pay their mortgage and put food on the table should something occur.

Since before I came to Congress, modernizing the insurance regulatory structure has been a critical issue throughout the industry. The problem our nation faces is not a new one. Sectors of this industry must continuously transform themselves to remain competitive. There's no question the states have been working feverishly to come to a consensus on a number of issues, however this effort has lacked the uniformity to consider the effort a success. Whatever regulatory structure is in place must have both uniformity and the flexibility to change as the industry changes. Without uniformity, competition is disadvantaged, prices remain unnecessarily high, and consumers suffer. Many people throughout the industry agree a dual regulatory system, similar to what we have seen work in the banking sector, is the right solution to this problem. While a dual system might be something to move towards down the road, I believe it is only prudent at this time, to support the incremental steps Chairman Oxley and Chairman Baker have proposed, allowing limited federal involvement a chance.

I want to thank everyone again for coming in today. I look forward to working with both my constituents and the industry in developing legislation with the intent of creating a more competitive insurance market, inevitably resulting in more choices and lower costs to people in Staten Island and Brooklyn looking for their first layer of security.

March 31, 2004

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Hearing entitled, "Working with State Regulators to Increase Insurance Choices for Consumers"

Thank you, Mr. Chairman, for calling this important hearing and for your continued leadership on this issue. Over the past three years, this committee has held fourteen hearings and roundtables on the need for insurance regulatory reform and, just recently, Full Committee Chairman Oxley and Subcommittee Chairman Baker developed a series of goals and concepts to guide our ongoing debate in this regard.

I look forward to our discussion this morning of ways to make our state regulated insurance system more efficient, uniform, and effective for all its customers. After our extensive review of this issue, I think we can all see how consumers would benefit from more uniform standards and processes for product review and sales oversight nationwide.

I know that Ohio's consumers and specifically the residents of Ohio's Fifth District are pleased with the job that our Department of Insurance Director Ann Womer Benjamin is doing to make Ohio's insurance industry accessible and accountable to consumers, to sustain the vitality of the insurance industry in Ohio.

However, last year's General Accounting Office (GAO) report that detailed "inconsistent and often spotty coverage from state to state and potential gaps in consumer protection" in the insurance industry needs to be addressed.

We have a great starting point for our discussion today with Chairmen Oxley and Baker's proposal and I look forward to a productive session.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON WORKING WITH STATE REGULATORS TO INCREASE INSURANCE CHOICES FOR CONSUMERS

WEDNESDAY, MARCH 31, 2004

Mr. Chairman, thank you for the opportunity to offer my thoughts about regulatory reform in the insurance industry before we hear from our distinguished witnesses.

First and foremost, I commend you for continuing to focus our committee on the issue of insurance regulation. During the last three years, our panel has met on multiple occasions to discuss a wide variety of issues related to the insurance industry. As a result of these proceedings, we have developed a better understanding of the insurance marketplace.

We have additionally begun to form a growing consensus in the Congress about the need to improve insurance regulation in the United States. In an attempt to advance these efforts, Mr. Chairman, you also recently developed an initial outline for achieving incremental regulatory reform in the insurance industry. This evolving proposal has already sparked considerable debate in the insurance community.

Although it merits receiving our collective attention, I suspect that we will eventually conclude that this reform plan to impose a new federal bureaucratic network over an existing state regulatory structure will produce unintended consequences. Later today, for example, one of our witnesses will detail the shortcomings of this outline with respect to the protection of consumers and the needs of small businesses. By inserting the federal government into insurance regulation, this plan will also almost certainly create new, unfunded liabilities for our country.

Additionally, I suspect that many will conclude that this initial proposal falls considerably short of achieving permanent and genuine reform in insurance regulation. The outline under consideration today, for instance, envisions a weak federal coordinator with little enforcement authority. Calling for greater uniformity in insurance regulation but then giving the new federal overseer limited powers is much like watching an old man trying to eat an apple after removing his false teeth. Some have also suggested that the federal regulatory presence envisioned by this proposal could do more to confuse, rather than clarify, regulatory responsibilities.

During our previous hearings on insurance reform, we have received extensive testimony from many witnesses advocating the creation of an optional federal charter. Although the plan before us today does not address this important issue, the consensus for creating an optional federal charter continues to grow. Earlier this year, the National Association of Insurance and Financial Advisors decided to embrace certain federal initiatives that would work to improve the regulation of insurance, including the development of an optional federal charter. A study released earlier this week by Sheila Bair, a former Bush Administration official, and her team of researchers also advances the idea of creating an optional federal charter.

(more)

The reform package under consideration today would create a system of joint regulation between the federal and state governments. Rather than overlaying a federal bureaucracy on top of state regulation, an optional federal charter would create a separate, streamlined regulatory system. Such dual oversight has worked generally well for the banking industry for many decades, and we should now consider applying it to the insurance industry as well. Moreover, because of its standardized products and nationwide marketplace, the life insurance industry, in my view, is particularly ready for the adoption of an optional federal charter.

Mr. Chairman, the devil, as they often say, is in the details. Because much of the proposed regulatory reform outline is currently conceptual, it is difficult at this time to anticipate how the legislative language would actually work. Despite my initial doubts, I want you to know that I am approaching today's hearing with an open mind because I share your goals of making insurance regulation more efficient, uniform and effective for consumers.

In closing, Mr. Chairman, we have reached a fork in the road and must decide which path to take. Ultimately, we might decide to modify and adopt this conceptual plan before the 108th Congress completes its work. We might alternatively decide to create a commission to study these matters. We might also decide to begin the considerable work needed to create an optional federal chartering system in a future session. These are important discussions for us to have and important matters for us to resolve.

STATEMENT OF TOM AHART
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

March 31, 2004

Good morning Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is Tom Ahart, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA) and to provide our association's perspective on the role that Congress can play in enhancing and improving state insurance regulation. I am President of Ahart, Frinzi & Smith Insurance Agency, an independent agency based in Phillipsburg, New Jersey, and I served as president of IIABA from September 2001 to September 2002.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent 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 offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products.

I. Introduction

Mr. Chairman, on behalf of the IIABA, I want to express our association's strong support for the conceptual approach to insurance regulatory reform that you have developed with Chairman Oxley. In our view, the Oxley/Baker roadmap, which calls for the targeted and focused use of federal legislation to modernize the core areas of state insurance regulation, offers legitimate hope for the first time that enactment of national regulatory reform may be possible to the benefit of consumers across the country.

I commend the subcommittee and full committee for their continued interest and diligent work on the challenges facing our longstanding system of state insurance regulation. Nearly two years ago, I first had the opportunity to address this subcommittee and outline our association's strong opposition to the creation of a federal regulatory structure and our alternative vision for securing meaningful and effective reform of state insurance regulation. Since that time, you and your colleagues have carefully and thoroughly examined the failings of insurance regulation over the

course of more than a dozen hearings. Those efforts have highlighted the lack of uniformity and consistency that exists among the states, the unnecessary regulatory hurdles that insurers and agents face, and the negative effects that the current system has on competition and consumer choice within the financial services world. Finally, your work has examined and identified the areas of state insurance regulation that are most in need of reform – agent/broker licensing, insurer licensing, insurance product (rates and forms) regulation, and market conduct.

When I testified before this subcommittee in 2002, I explained that our association strongly supported state regulation of the insurance industry – and we remain committed to that overarching principle today. IIABA believed then, as we do today, that state insurance regulation should be preserved and strengthened, but we recognized that the states were unlikely to resolve their problems on their own in a timely manner. For this reason, I urged Congress to utilize targeted federal legislation to address the components of the state system that had failed while not jeopardizing consumer protection in any respect. IIABA has continued to promote this pragmatic approach to reform among our industry colleagues and partners, and we are pleased that a broad array of insurers and insurance producers now support it.

II. IIABA's Support for Targeted Reforms

IIABA's perspective on insurance regulatory reform is well-known and has remained consistent throughout this subcommittee's consideration of these issues. We oppose federal regulation of insurance for the substantive and political reasons that have been outlined in our previous testimony. Instead, our organization supports the enactment of targeted and limited federal legislation that builds on, rather than dismantles, the states' inherent strengths to meet the challenges of our rapidly changing marketplace. Although we strongly support state insurance regulation and the consumer protections it inherently provides, we believe there is an urgent need to address the deficiencies and inefficiencies that exist in the system today. In our view, the most effective way to obtain these needed reforms is through the focused use of federal legislative action.

The enactment of federal legislation to address the problems with state regulation today is not a radical concept. Congress proved that such an approach can work when it passed the NARAB provisions of the Gramm-Leach-Bliley Act. This reasonable approach offers an opportunity to address the legitimate criticisms lodged against the current system and would improve and enhance state insurance regulation without replacing it altogether. There is widespread consensus among observers – including state and federal legislators, regulators, and the insurance marketplace – that insurance regulation needs to be updated and modernized, and congressional action can quickly bring about reforms that have been sought by state policymakers for years. The states face considerable collective action challenges in enacting consistent statutes in all jurisdictions, and Congress can assist their efforts by implementing key reforms nationally. There are only a handful of regulatory areas where uniformity and consistency are imperative, and Congress has the ability to address each of these core issues on a national basis in a single legislative act.

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. The goal should be to establish more consistent requirements and regulatory procedures and ultimately create a more efficient, modernized, and workable system of state insurance regulation. We believe Congress can, and should, help state policymakers create a more uniform and market-oriented system on a national basis while preserving and strengthening the regulatory infrastructure at the state level. In this way, we can assure that insurance regulation will continue to be grounded on the proven expertise of state regulators.

III. Regulatory Reform Roadmap

Two weeks ago, Chairman Oxley provided his and Chairman Baker's vision for reform in a speech before the National Association of Insurance Commissioners (NAIC) entitled "Roadmap to State-Based Insurance Regulatory Reform." At that time, Chairman Oxley outlined a conceptual foundation for targeted federal legislation that would address the problems in state insurance regulation identified by this subcommittee over the last three years. Our association strongly endorses the roadmap's conceptual approach to reform. We were very pleased to hear Chairman Oxley say that the committee is not contemplating an optional federal charter and will not create a federal regulator or a dual federal-state regulatory system.

With the development of this initial roadmap, the subcommittee and full committee's examination of insurance regulation has left the investigation and study stage and has progressed to the policy development and action stage. To paraphrase Winston Churchill, the subcommittee's efforts in this area have reached the "end of the beginning." The Oxley/Baker blueprint provides an excellent starting point for the discussions that will follow, and we look forward to working closely with the committee on the details of any future legislative proposal. In our view, this conceptual framework is the most effective and appropriate manner in which to obtain overdue reforms, and we are pleased that interested parties are quickly lining up to support the targeted use of federal legislative tools.

The roadmap outlines a series of policy goals and objectives, and many of the items included are similar to ideas that IIABA has contemplated in recent months. These goals address the major areas in need of reform – licensing and access to the marketplace, product regulation and review, and market conduct. As you continue consideration of the goals of future legislation and also begin to develop the mechanisms for obtaining the stated objectives, we thought it would be appropriate to again outline our vision of how a congressional proposal could address the major issues of the day. We have done so below.

Property-Casualty Product Regulation

The need for "speed-to-market" reform is profound on the property and casualty side of the insurance industry, where insurers are required to obtain formal regulatory approval for products before introducing a new rate or form into the marketplace. Many states currently regulate the development and introduction of new products in ways that cause significant and unnecessary delays, undermine the forces of competition, and create affordability and availability problems

for consumers. These unnecessary delays and inefficiencies mean that insurers and their agents cannot be as responsive to their consumers as they desire to be.

IIABA believes that Congress should adopt a series of reforms in this area that have four primary effects: (1) make product oversight more market-oriented; (2) provide for the quicker development and introduction of new insurance products; (3) reduce or eliminate unnecessary duplication within and among states; and (4) create greater accountability. Specifically, our association hopes to secure the following outcomes with respect to these goals:

- All states should articulate and specify the standards that apply to the consideration of new policy forms, and all jurisdictions should eliminate so-called "desk drawer rules" that are not rooted in enacted legislation or properly promulgated regulations.

- All states should accept filings from insurers via an electronic single point-of-filing system, such as the NAIC's System for Electronic Rate and Form Filing.

- All states should utilize a common process for the review of new policy forms (whether for commercial or personal lines of insurance). Under such a system, every state could be required to take action on a newly filed form within 30 days. If the form is not acted upon within the 30-day window, then it would be deemed approved. If the form is ultimately disapproved, then the relevant state regulator would be obligated to clearly and specifically disclose the statutory or regulatory basis for the disapproval.

- Finally, states should rely on the forces of competition to establish insurance rates, eliminate the ability of regulators to establish prices, and continue to ensure that all insurance rates are neither discriminatory nor inadequate. This model for regulation has worked well in Illinois for years and more recently in a growing number of other jurisdictions, such as South Carolina.

Life Insurance Product Regulation

With regard to life insurance product oversight and consistent with the Oxley/Baker blueprint for reform, IIABA supports efforts to ensure the nationwide adoption of the NAIC's Interstate Insurance Product Regulation Compact. This proposal would provide product standards for life insurance products and provide a central point of filing for insurers. The adoption of the interstate compact proposal has been a priority for many in the insurance marketplace and for such policy groups as the NAIC, the National Conference of Insurance Legislators (NCOIL), and the National Conference of State Legislatures (NCSL). Unfortunately, the compact proposal has only been adopted in a very small number of states to date.

Agent/Broker Licensing

Insurance producers of all kinds – whether operating in large commercial centers or small communities – face unnecessary bureaucratic hurdles that are imposed by distinct and often idiosyncratic licensing laws. Although most states have now enacted licensing reform statutes that provide reciprocity to licensed agents and brokers, various burdens and difficulties remain.

Several of the larger states still have not enacted licensing reciprocity, and many of the states that did pass licensing reform deviated from the NAIC's model law. The resulting lack of uniformity and consistency among the states makes compliance a challenge, and states still differ dramatically in the manner in which they handle nonresident licensing and renewals.

In order to enhance and improve the licensing environment facing agents and brokers, IIABA urges the subcommittee to consider the following licensing reforms:

- National licensing reciprocity – We urge the subcommittee to expand the Gramm-Leach-Bliley Act's reciprocity mandate to all states and establish a nationally reciprocal licensing structure in the process. Similarly, federal legislation should be used to preempt nonresident continuing education requirements and other requirements that have the effect of limiting or conditioning a nonresident's activities solely because of that person's residence or place of operation.

- Licensing uniformity – Additional uniformity is necessary in certain licensing areas, and a targeted federal proposal should help establish greater multi-state licensing consistency for agents and brokers.

- Countersignature laws and other restrictive barriers – IIABA seeks the outright preemption of all remaining mandatory countersignature laws and similar barriers to effective multi-state commerce.

- Background checks – IIABA also supports the enactment of the background check provisions that were included in H.R. 1408 as adopted by the House during the last Congress. The protections and safeguards that were contained in H.R. 1408 struck the appropriate public policy balance and should be included in any new legislation.

Insurer Licensing

Agents and brokers are not the only insurance entities that face challenges obtaining access to new jurisdictions, and insurance companies often face similar burdens. Consumers are best served by a healthy and vibrant marketplace with numerous competitors, and insurers should not face unnecessary delays and costs when attempting to enter new states. For this reason, we support a move toward a nationally uniform set of standards or a common process for licensure that would apply in every jurisdiction.

Market Conduct

Both Congress and state policymakers have identified the market conduct area as one of the aspects of insurance regulation most in need of modernization, and IIABA agrees that action in this area is warranted. We suggest that Congress examine the model law recently adopted by NCOIL and apply it nationally. Many states do not have a statutory foundation for their market conduct oversight activities, and the new model is intended to establish that formal framework. The model outlines a procedure for performing regular market analysis to determine patterns of

misconduct, establishes a continuum of market conduct actions, creates protocols and procedures for onsite exams, and promotes uniformity and coordination among the states.

Dispute Resolution Mechanism

If Congress were to enact a law based on the goals and objectives contained in the recently released roadmap, IIABA recognizes that some mechanism is necessary to address disputes that might arise under the act. For example, if standards are established or preemption is utilized, then some arbiter will likely be needed to determine whether the states are acting in a manner consistent with the new federal law. IIABA believes any such process or mechanism must be limited in its power and authority and should be obligated to act quickly and effectively. In addition, any structure that is established must not become a backdoor federal regulator.

Perhaps more than in any other area, IIABA is interested in working with the committee on this portion of a proposal, and we look forward to working closely to ensure that no federal entity takes on any formal regulatory or licensing power and that the courts retain their final authority to judge disputes that arise under any future act.

IV. Conclusion

This subcommittee's productive and thoughtful work over the last three years has highlighted the flaws that exist with state insurance regulation, and it has showcased the need for timely action. In order to serve consumers effectively and to compete with other financial services offerings, insurance providers must have efficient access to state marketplaces and the ability to develop and introduce products in a timely fashion. For the first time, the Oxley/Baker roadmap offers hope that meaningful reforms can be enacted that address existing inefficiencies, barriers to efficient competition, and the lack of multi-state uniformity. We believe the framework identified in the roadmap is the most effective way to bring about such reforms at the state level and that the use of targeted federal legislation will bring about greater consistency and other needed reforms across state lines.

The Oxley/Baker roadmap offers an excellent starting point for beginning the discussion of how to reform and strengthen state insurance regulation. The IIABA strongly supports the state-friendly vision of regulatory reform articulated by Chairmen Oxley and Baker. Using targeted federal legislation makes good sense because it can be applied to nearly every important area of state insurance regulation and different legislative tools can be utilized in a tailored fashion on an issue-by-issue basis. There are no one-size-fits-all solutions, and this committee and Congress will have the opportunity to make use of the wide variety of legislative tools at its disposal in a way that strengthens and preserves state insurance regulation.

IIABA again commends this subcommittee for its efforts, thanks Chairmen Oxley and Baker for the development of their blueprint, and looks forward to working in partnership with all interested parties on the development of a formal legislative proposal.

THE
COUNCIL
OF INSURANCE
AGENTS &
BROKERS

Statement of

Albert R. Counselman, CPCU
President & CEO, Riggs, Counselman, Michaels, Downes, Inc.

On

"Working with State Regulators to Increase Insurance Choice for Consumers"

Before the

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

March 31, 2004
Washington, D.C.

Statement of Albert R. Counselman, CPCU, President & CEO, Riggs, Counselman, Michaels & Downes, Inc.

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

"Working with State Regulators to Increase Insurance Choices for Consumers"

March 31, 2004

Good morning, Chairman Baker, Ranking Member Kanjorski and members of the Subcommittee. My name is Albert Counselman. I am President and CEO of Riggs, Counselman, Michaels and Downes in Baltimore, MD and past Chairman of The Council of Insurance Agents + Brokers ("The Council"). Thank you for giving me the opportunity to testify before the Subcommittee today.

Riggs, Counselman, Michaels and Downes is the largest independent agency/brokerage firm in Maryland, with more than 225 employees. We are headquartered in Baltimore, with offices in Washington and Richmond. Based on information reported by Business Insurance in their annual survey of firms, RCM&D is the 85th largest insurance/risk management in the U.S. Our clients range from large, multi-state employers in the Fortune 1000, to large and small hospitals, to mid-size and small businesses and individuals. We provide risk management, including risk control and claim management programs, commercial and personal insurance, self-insurance and employee benefit programs. We represent most of the largest and most well known insurers operating in the U.S. and many located overseas. We have been in business since 1885 and continue to be privately owned by individuals active in the operation of the business. Through our ownership and membership in organizations such as Assurex Global and Worldwide Brokerage Network, we service clients locally as well as throughout the U.S. and the globe.

Introduction

RCM&D and the members of the Council of Insurance Agents + Brokers heartily embrace your road map to insurance regulatory reform. We commend you and your colleagues for the years of work and numerous hearings into the shortcomings of the state-based insurance regulatory system that have led to this proposal. The road map

lays the groundwork for aggressive reforms that will go a long way toward providing desperately needed modernization in insurance regulation. It builds upon state-based efforts and provides both carrots and sticks to force states to effectively respond to the critical need for reform.

Although the NAIC has attempted efforts to lead reform without federal involvement, the reality is that today's marketplace demands far more dramatic action. The pace of financial services convergence and globalization are far outstripping the pace of individual reform efforts by state regulators and legislators. Competition and efficiency in the insurance industry lags behind other financial services sectors for the exact reasons stated by Chairmen Baker and Oxley – there are glaring 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.

The Council regards itself as a pioneer within our industry with respect to regulatory modernization, though reform is a frustratingly long process. We formed our first internal committee to address the problems of interstate insurance producer licensing more than 60 years ago. Our efforts were finally rewarded with the enactment of the NARAB provisions of the Gramm-Leach-Bliley Act a few years ago – a first step on the road to insurance regulatory modernization. We thank you, Mr. Chairman for your leadership on this issue, and other Members of this Subcommittee on both sides of the aisle for your active support of the NARAB provisions during the legislative process that ultimately culminated in enactment of the Gramm-Leach-Bliley Act.

NARAB was a true provision of modernization in the Gramm-Leach-Bliley Act. Were it not for the tenacious support and initiative from Chairman Baker and Congresswoman Kelly, and the leadership of Chairman Oxley, things assuredly would not be changing for the better – particularly at their current pace. This initiative was bipartisan, and provides a very good model for the carrot-and-stick, goals-and-timetables approach contemplated by the road map, which we believe can effectively move insurance regulation forward toward more streamlined, efficient and rational regulation.

The Council has been studying the different routes for achieving modernization in the insurance regulatory process. To that end, The Council's Foundation for Agency Management Excellence (FAME) commissioned an independent study of the economic costs and benefits of these various proposals (the "FAME Study"). While it is abundantly clear to Council members that the current system of state-by-state regulation is not working, we wanted to see a full, economic analysis of the alternatives for reform. 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. We released this study during

one of the hearings you held to examine these issues, and I hope the study has served as a useful tool in the development of the regulatory reform proposal.

Even though the states have made some strides in recent years in simplification and streamlining – thanks to the enactment of the NARAB provisions of Gramm-Leach-Bliley – there are still several problem areas in the interstate licensing process that cost our members time and money unnecessarily. Insurance companies also face problems in doing business on a multi-state basis, and recent efforts by the states to streamline rate and policy form approval processes have not proven to be very successful. These continuing issues with the state-by-state regulatory process lead us to the following conclusion: relief is needed, and it is needed now. The committee's tireless work on this issue, culminating in the road map to reform, indicate to us that you agree with our assessment.

Specific Reform Comments

The Council believes it is critical to the long-term viability of the U.S. insurance industry that Congress pass legislation to address the deficiencies of the state insurance regulatory system. Broad reforms to the insurance regulatory system are necessary to permit the industry to operate on a more efficient basis. Such reforms, like the road map to reform, are also necessary to enable the insurance industry to compete in the larger financial services industry and internationally. There are also more immediate needs, however, that are consistent with the regulatory reform proposal. I would like to focus on three areas that could greatly benefit from immediate reforms that would be relatively easy to implement.

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

a. Producer Licensure

The NARAB provisions included in the Gramm-Leach-Bliley Act (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.

The NAIC pledged not only to reach reciprocity in producer licensing, but also to establish uniformity in producer licensing as their ultimate goal. The NAIC amended its Producer Licensing Model Act (PLMA) to meet the NARAB reciprocity provisions, and is working to get the PLMA enacted in all licensing jurisdictions. As of today, forty-seven states have enacted some sort of licensing reform. Most of those states have enacted the

PLMA, but four states have enacted only the reciprocity portions of that Model Act. Of the states that have enacted the PLMA, there are several states that have deviated significantly from the original language of the Model Act. One state 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 NAIC has now officially certified that a majority of states have met the NARAB reciprocity provisions, thereby averting the creation of NARAB. While that is a commendable accomplishment, there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions. The inefficiencies and inconsistencies that remain in producer licensing affect every insurer, every producer and every insurance consumer. As for my own firm, we hold 161 resident licenses in Maryland and Virginia, and 332 non-resident licenses across the country, up from 175 non-resident licenses in 1999. We not only had to secure initial licenses, but we face annual renewals for those nearly 500 licenses in 50+ jurisdictions, in addition to satisfying all the underlying requirements and post-licensure oversight. Progress in streamlining the producer licensing process has undeniably been made since GLBA's NARAB provisions were enacted in 1999, but these numbers – and, more critically, the regulatory and administrative burdens they represent – vividly demonstrate that the job is not yet finished. 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 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 Director Csiszar's South Carolina, do not use the common form, and, in those states that do use the form, there is no common response. Each state follows up individually, which can be cumbersome and confusing. An egregious example occurred in our attempts to renew licenses in the District of Columbia last year. Renewal applications were submitted in April 2003 and approval of the final renewal was received just last month after many attempts to follow up.

Thus, we believe reciprocity must be nationwide, and uniformity must be the ultimate goal. For example, if all state insurance commissioners know that agents and brokers must meet the same standards for resident licensure in every state, then no state insurance commissioner should have concerns about licensing nonresident agents and brokers on a reciprocal basis. Areas that would be good candidates for uniformity standards include the agent appointment process, continuing education and pre-licensing education requirements, and criminal history reviews.

I realize that increased uniformity in resident licensing requirements will raise the standards in some states. The Council has historically taken the view that the level of professional requirements for state insurance licensing are not very high when compared to other fields of professional endeavor. However, there are many duplicative and unnecessary requirements that have little or nothing to do with standards of professionalism. Council members have not had a problem with meeting high professional standards; our problem has been with having to meet those standards multiple times in different states. This is why The Council supported the requirement that membership standards for NARAB meet or exceed the highest levels currently existing in the states.

There are other areas in agent and broker licensure that would benefit from increased uniformity, as well. For example, the PLMA did not address license tenure and renewal dates. While this may seem like a small issue, it can easily turn into a large problem for someone like me, who is licensed in all 51 jurisdictions. I must constantly renew licenses throughout the year, based upon the individual requirements in each state. Even if all jurisdictions reach licensing reciprocity, without the development of a uniform standard in this area, I will have to continue to file license renewals throughout the year. The development of a uniform standard in this area would be of enormous benefit to me and millions of other producers in the nation.

b. Firm Licensure

Another area that would benefit from increased uniformity is the licensure of business entities. Perhaps due to confusing and contradictory state requirements, many insurers recently have started pushing for producers and their firms to be licensed in non-resident states. They no longer are accepting the location of the primary business of an insured as the state in which the producer needs to comply with licensing requirements, rather they are asking for firm and individual licenses in all states where the insured has locations. In South Carolina, for instance, our firm has had a difficult time securing payment of commissions because of questions about incorporation requirements. This not only has a regulatory and administrative implications for firms such as mine, but it has tax implications, as well, because many states require firms to be registered with the state prior to securing a producer license.

The licensure of business entities was not addressed in NARAB, and, until this issue is addressed, we have only solved half the licensing problem. Nearly all states license business entities, but the rules for their licensure vary widely. Additionally, some states will not currently license nonresident business entities. And once a nonresident business entity license is secured, the rules on how that entity may operate vary widely from state to state. Because Council members sell and service commercial insurance policies and employee benefits for large companies in all states, and because we must be licensed in all of those states, it is absolutely crucial that this issue be addressed as we move toward increased licensing uniformity.

c. International Considerations

Finally, The Council also believes that increased uniformity is critical as we move toward an increasingly global insurance marketplace. Many Council members sell and service insurance policies for customer with international operations. As we attempt to broaden international opportunities for U.S. insurance providers, we must be prepared to provide a model for our trading partners to follow. Permitting the states to keep the patchwork of licensing laws and regulations will do little to reinforce our arguments that other countries should open their markets to U.S. insurance providers; we must lead on this issue by our example.

Thus it is clear that, despite the revolutionary NARAB achievements, comprehensive reciprocity and uniformity in producer licensing laws remains elusive – and I am not sure that the NAIC and the states will be able to meet that goal. This is especially troubling, given the threat of federal intervention that was implicit in the NARAB provisions of Gramm-Leach-Bliley.

Indeed, until recently, the State of Florida completely barred non-residents from being licensed to sell surplus lines products to Florida residents or resident businesses. The state required non-resident agents and brokers who sold a policy of an admitted company to a Florida resident or resident business to pay a resident agent a mandated "countersignature fee" in order to complete that transaction. These practices have been terminated only because The Council filed a lawsuit and was granted summary judgment on its claims that these statutory requirements violated the constitutional rights of its members. The State has opted not to appeal and legislation has been introduced in the state legislature to repeal the unconstitutional statutory requirements. Unfortunately, we have heard reports that efforts have been made in the legislature to attach other protectionist – and non-reciprocal – requirements to the legislation. We should not have to resort to lawsuits to defeat these protectionist laws and put ourselves in a position to serve our clients in an efficient manner.

d. Reform Recommendation

I do not believe that the NAIC – despite its ambitious reform agenda – is in a position to force dissenting states to adhere to any standards it sets. Congress can, however, and I believe it can be accomplished under the contours set forth in the regulatory reform road map. We believe the regulatory reform proposal should build on GLBA's NARAB provisions, taking NARAB a step further by mandating that all 50 states enact uniform licensure laws or laws permitting an agent or broker licensed in one state to be licensed in all other states on a reciprocal basis and preempting all state insurance laws that discriminate against non-resident agents and brokers as the Florida provisions were found to have done.

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

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

Self-regulatory organizations (SROs) like the NASD provide a good model that could easily be modified to address the regulation of insurance producers. SROs are used quite commonly to regulate professional activities. For example, state bar associations are SROs that provide oversight of the legal profession. The Council's concerns with state-by-state licensing for insurance producers has never had anything to do with state regulation of insurance producers. Rather, our concerns have arisen from the myriad of idiosyncratic requirements that often have little or nothing to do with the professionalism of our members. The Council would prefer to see a single set of licensing requirements and rules of conduct that are meaningful in terms of expertise and proficiency, even if that means meeting the highest of standards that currently exist.

As part of the regulatory reform plan, the Subcommittee should strongly consider the use of an SRO to address the continuing problems in interstate producer licensing. The state insurance regulators have taken the first steps by adopting the PLMA and creating the National Insurance Producer Registry (NIPR), an affiliate of the NAIC that handles electronic filing of non-resident producer applications. The road map proposal could finish the job

by mandating state uniformity and permitting an insurance producer SRO to handle resident and non-resident licensing, renewals, appointments and continuing education.

It is important to note that nothing in the federal securities laws authorizes any specific entity to act as the SRO for securities brokers; rather it provides for the creation of SROs to regulate securities broker/dealers subject to SEC oversight. This same approach could work well in the insurance industry, as it would permit each segment of the producer marketplace (life, health, and property/casualty) to address its own unique issues. The supervising authority could be housed in the federal-state coordinating council contemplated as part of the regulatory reform proposal. Use of a supervised SRO to regulate industry activities could result in significant efficiencies and savings for consumers without diminishing the consumer protections in place today.

2. Speed To Market

There are other problems with the state-by-state system of insurance regulation that deserve immediate attention and that should be addressed in the regulatory reform proposal. While these problems appear to affect insurance companies more than insurance agents and brokers, we would argue that the restraints imposed by the state-by-state regulatory system on these areas 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.

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

The FAME study mentioned earlier in my testimony notes that the current U.S. system of regulation can be characterized as a prescriptive system that generally imposes a comprehensive set of prior constraints and conditions on all aspects of regulated entities' business operations. Examples of these requirements include prior approval or filing of rates and policy forms. The prescriptive approach is designed to anticipate problems and prevent them before they happen. However, this approach to regulation hinders the ability of the insurance industry to deal with changing marketplace needs and conditions in a flexible and timely manner. The

prescriptive approach to regulation also encourages more regulation than may be necessary in some areas, while directing precious resources from other areas that may need more regulatory attention.

It is also important to note that insurers wishing to do business on a national basis must deal with 51 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. Indeed, some studies have shown that it can take as much as two years for a new product to be approved for sale on a nationwide basis. Banking and securities firms, in contrast, can get a new product into the national marketplace in 30 days or less. The lag time for the introduction of new insurance products is unacceptable, and it is increasingly putting the insurance industry at a competitive disadvantage as well as undermining the ability of insurance consumers to access products that they want and need.

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 refile 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 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. These concepts are addressed in the outline of the regulatory reform proposal. We look forward to working with the committee regarding the review of policy forms, and we enthusiastically support the extension of the Illinois-style free-market competition with respect to price controls to the rest of the country. This will help to put insurance on an equal footing with all other financial products.

3. Increasing Access To Alternative Markets

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

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

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

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

The problems with state surplus lines laws fall into four general categories:

- Taxes: States have inconsistent and sometimes conflicting approaches regarding the allocation of premium taxes, which can lead to double taxation and confusion when a surplus lines policy involves multi-state risk.
    - Single situs approach – 100% of the premium tax is paid to the insured's state of domicile or headquarters state. (This approach is imposed by some states regardless of what percentage of the premium is associated with risks insured in the state.)

  - Multi-state approach – Premium tax is paid to multiple states utilizing some method of allocation and apportionment based upon the location of the risk.
  - No clear requirement – More than a dozen states that impose surplus lines premium taxes do not have statutory or regulatory provisions indicating the state's tax allocation method, leaving it up to the insured and the insured's broker to determine how to comply with the state law. In such states, determination of tax allocations is often based on informal guidance from state insurance department staff.

- Declinations: Some, but not all, states require that an attempt be made to place coverage with an admitted insurer before turning to the surplus lines market. Some states specifically require that one or more licensed insurers decline coverage of a risk before the risk can be placed in the surplus lines market. State declination requirements are inconsistent and conflicting, however, and the methods of proving declinations vary tremendously – from specific requirements of signed affidavits to vague demonstrations of "diligent efforts."
- Status of Insurers:
  - Most states required that a surplus lines insurer be deemed "eligible" by meeting certain financial criteria or having been designated as "eligible" on a state-maintained list. These lists vary from state to state, making it potentially difficult to locate a surplus lines insurer that is "eligible" in all states in which placement of a multi-state policy is sought. Although the NAIC maintains a list of eligible alien (non-U.S.) surplus lines insurers, this does not seem to have any bearing on the uniformity of the eligible lists in the individual states.
  - In addition to eligibility, another problem with respect to the status of insurers occurs when surplus lines coverage is placed with an insurer that is an admitted (not surplus lines) insurer licensed in a state where part of the risk is located. This is problematic because surplus lines insurance cannot be placed with a licensed insurer.
- Filings: All states require surplus lines filings to be made with the state insurance department. The type and timing of such filings vary from state to state, but may include filings of surplus lines insurer annual statements, filings regarding diligent searches/declinations, and filings detailing surplus lines transactions. Depending on the states in question, filings can be required annually, quarterly, monthly or a combination thereof. In addition, some states treat "incidental exposures" – generally relatively small surplus lines coverages – differently from more substantial coverages. States have differing definitions of what constitutes incidental exposures and who has to make required filings for such an exposure: some states require the broker to make the filings; others the insured; and some require no filings at all for incidental exposures.

My hope is that Congress can act to alleviate these problems by creating incentives or requirements for the states to rationalize their irrational surplus lines requirements. We would welcome the opportunity to work with the committee to incorporate sensible surplus lines provisions into the regulatory reform legislation to address these issues, such as the establishment of a clear rule that the only applicable surplus lines laws to a multi-state transaction are those of the state in which the insured is headquartered; creation of a clearinghouse for allocation of premium tax payments; establishment of a national "eligibility list;" and creation of national standards for declinations and information filings.

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

The rationale underlying the single-state regulation of RRGs is that they consist only of "similar or related" businesses which are able to manage and monitor their own risks. The NAIC has recognized that the purpose of Risk Retention Groups is to "increase the availability of commercial liability insurance."

RRGs are working. They have created an alternative market for liability coverage that serves a valid and important purpose and a market segment that otherwise would be difficult or prohibitively costly to cover. We believe Congress should expand the availability of RRGs by expanding the Liability Risk Retention Act to allow coverage of property damage as well as liability exposures. This would provide another alternative for businesses seeking economical insurance solutions in difficult economic times for the insurance industry.

I know that some are opposed to expansion of RRGs, arguing that single-state regulation constitutes a "race to the bottom" with respect to regulatory supervision. Although I do not agree with that concern, I would support a requirement limiting RRG domiciliary states to those states that are accredited by the NAIC. Thus, all RRGs would be subject to the same solvency requirements and regulation regardless of their state of domicile.

Moving Forward

The FAME study notes that all of the regulatory modernization efforts put forward by the NAIC in the past several years have been the direct result of major external threats – either the threat of federal intervention, or the wholesale dislocation of regulated markets. It concludes that there is no guarantee that the state-based system will adopt further meaningful reforms without continued external threats to its jurisdiction, and offers the states' progress on producer licensing reform as a prime example. The Council wholeheartedly agrees with this conclusion, and believes your road map to regulatory reform is an excellent vehicle to force the states to make the reforms necessary to address the glaring deficiencies of the state system. Too much protectionism and parochialism interferes with the marketplace. The incentive for reform in individual states simply does not exist without a federal threat. Thus, a congressional partnership with the states is entirely in order, and overdue.

The Council looks forward to working with you and your staff to develop the "road map to reform" from concept into reality. As I have mentioned, we believe there are several targeted reforms that the Congress could address in the reform legislation that will benefit not only the insurance industry but also the consumers we serve. Bringing further improvements and uniformity to the producer licensing system and addressing the speed-to-market shortcomings in the current state system by eliminating prior approval of rates and policy forms, similar to the successful model used in Illinois, are two essential elements of reform that are currently contemplated in the road map. We would also like to suggest that additional reforms could be made to foster growth and expand access to alternative insurance marketplaces for sophisticated commercial insureds. Such reforms would further the goal of eliminating inconsistent and inefficient regulatory requirements and thereby expanding the insurance marketplace for the benefit of insurers, producers and consumers.

In closing, as I noted above, improvements in the state insurance regulatory system have come about largely because of the leadership of this Committee, and through your continued oversight of the regulatory process. The regulatory reform proposal is the next step in this diligent effort. On behalf of The Council, I thank you for your attention to this critical issue, and also thank Chairman Oxley and Rep. Kanjorski for their leadership in this area. We stand ready to assist you in any way that we can to advance this important effort.

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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:
"Working with State Regulators to Increase Insurance
Choices for Consumers"

Wednesday, March 31, 2004

Ernst Csiszar
Director of Insurance, South Carolina
2004 President,
National Association of Insurance Commissioners

Testimony of Ernst Csiszar, 2004 President
National Association of Insurance Commissioners

Introduction

Good morning, my name is Ernie Csiszar. I am President of the National Association of Insurance Commissioners and Director of Insurance for the State of South Carolina. Two weeks ago, Financial Services Committee Chairman Oxley spoke to our organization about various regulatory reform concepts he is proposing. At that meeting, he solicited the input of the NAIC on those regulatory reform concepts, and encouraged us to work together as partners to create a regulatory scheme that would provide stable insurance markets and protect insurance consumers. Thank you for allowing us the opportunity to appear today before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises to provide input on the broad regulatory reform concepts outlined by Chairman Oxley.

Shared Goals

We want to continue our partnership with Congress to modernize and reform state insurance regulation. As partners, we look forward to having a seat at the table to provide comment, insight, and input on achieving high regulatory standards, better competition, greater consumer choice, marketplace stability, and consumer protections. We share Chairman Oxley's and this Committee's goals for modernizing state insurance regulation. Our work over the past three years demonstrates our commitment to regulatory uniformity and modernization.

Responding to Chairman Oxley's Specific Goals

In response to Chairman Oxley's request for input, we would like to respond to the specific regulatory reform concepts he believes should form the basis of an effective system of national insurance regulation.

1. Goal for Life Insurance Products: Build off of System for Electronic Rate & Form Filings (SERFF) and a strengthened Interstate Compact to achieve single-point filing and time-certain review of life insurance products such as annuities, life insurance, and long-term care. NAIC fully supports achieving electronic single-point filing for all insurance products, and we have a system for implementing it. Filings submitted through this single point of entry tripled in 2003 over 2002, and filings in 2004 are expected to reach 140,000 to 150,000. More than 20 states are considering the Interstate Insurance Product Regulation Compact, which creates uniform national standards for products filed with the compact and provides a central point of filing for life insurers

2. Goal for Other Insurance Lines: Single point of filing with expedited review based on clear standards for personal forms, including auto, homeowners, and other property-casualty insurance lines. NAIC supports the goal of single point of filing and expedited review, but also recognizes that property-casualty insurance rates, forms, and claims on personal lines are inherently linked to local conditions and state laws that vary across the United States. The state system accommodates variations in these local conditions because consumers in Ohio do not want to pay auto or homeowners rates based upon losses experienced in California, Florida, Massachusetts or elsewhere. States have implemented review standards checklists that clearly describe – in plain English – what an insurer must do to receive authorization to sell its products. Forty-five states have already adopted checklists and posted them on the internet for easy access by insurers. These checklists enumerate the standards that states apply during filing reviews and are product specific.

3. Goal for Commercial Policyholders: Single choice-of-law for large multi-state commercial policyholders, and limited review for sophisticated commercial policyholders. Commercial insurance rates and products are not closely regulated by states because the buyers are sophisticated professionals and the products are

specifically tailored for each customer. NAIC is willing to work toward streamlining commercial law differences that can be addressed through the insurance regulatory system when we receive more details about existing problems identified by the Financial Services Committee.

4. Goal for Setting Rates Through Competition: Illinois-style free-market competition (like all other financial products) for personal property-casualty insurance lines. The business of insurance and the methods for regulating it are much different from other financial products like banking and securities. Based upon many years of effort, we do not believe a single national rating or product regulation model for personal property casualty insurance lines is appropriate or feasible, whether imposed by the states or the federal government. The significant differences in risks and local conditions from one state to another produce challenges to a "one size fits all" regulatory approach for such essential products as homeowners and auto insurance. Regulators are working to harmonize rate and form filings among states, while recognizing that the difficult issues underlying them are best handled at the state level. Of the fifty-one regulatory jurisdictions, there are only 15 that apply a prior approval rating environment for all personal lines policies. There are three jurisdictions that use a different system for auto insurance than for homeowners coverage, and the remaining 36 jurisdictions apply some form of competitive rating for both auto and homeowners insurance.

5. Goal for Insurance Company Licensing: Single point-of-entry for insurance company licensing based on adequate standards under ALERT. NAIC fully supports this goal, and states are currently implementing it. All jurisdictions accept the NAIC Uniform Certificate of Authority Applications (UCAA), which provides a standard set of filing requirements for insurers seeking licensure in a state. Electronic systems for facilitating the UCAA filing, initially put in place in 2001, are presently undergoing substantial modifications to significantly streamline the completion of applications. The system is being made "smarter"

by programming it to interface with the NAIC Financial Data Repository to allow for semi-automated completion of a UCAA. We are also codifying best practices and procedures for assessing licensing applications, which is intended to raise the level of consistency among states' decision-making processes for issuing or denying licensing authority.

6. Goal for Licensing of Agents: Nationwide reciprocal licensing for agents, with movement towards uniformity. NAIC fully supports this goal, and states have successfully implemented licensing reciprocity consistent with NARAB requirements. However, it is important to note that current lack of uniformity and non-compliance with NARAB for some states does not mean lower licensing standards. For example, full legal certification to meet national requirements under NARAB would require states such as California and Florida to actually lower their standards for fingerprinting license applicants to prevent fraud. The NAIC has developed a draft Authorization for Criminal History Record Check Model Act, and continues to have informal discussions about access to the FBI's criminal history database with representatives of the FBI. While states are currently able to obtain access to the FBI database through the adoption of proper legislative authority, federal law prohibits states from sharing criminal history record information with each other. The NAIC continues to seek solutions to resolve the prohibition against the sharing of information, and has asked Congress for full statutory authority to access FBI fingerprint files so that national uniform producer licensing can be effectively implemented.

7. Goal for Market Regulation: Ensure nationwide and uniform adoption of a consensus market conduct law. NAIC fully supports this goal, and states are currently working to implement a common market regulation system derived from the best practices and approaches that exist within the state insurance regulatory community. These practices include market analysis and a continuum of regulatory responses based upon that analysis, uniform examination procedures, interstate collaboration for multistate problems, and uniform collection of market

data. We are committed to moving forward aggressively on these practices. For example, every state has appointed a market analysis coordinator, and training on market analysis techniques is scheduled to begin in May.

8. Goal for Federal-State Insurance Coordination: Create an evenly divided federal-state insurance coordination council without regulatory authority that can help resolve conflicts between state and federal policies and advise the President and Congress on insurance tax policy. A Presidential appointee would additionally be created without any regulatory or licensing power for the sole purpose of approving or disapproving the coordination recommendations of the council. We understand from Chairman Oxley that the creation of a federal administrative body to oversee insurance regulation must be explored carefully. We concur. Legislation that creates a federal regulator or some other entity may do more to confuse, rather than clarify, regulatory responsibilities. We are concerned that any organization established under federal law to interpret and oversee implementation of national regulatory standards would inevitably raise troublesome questions of "who's in charge" of state insurance regulation. Regulatory confusion in the dynamic insurance marketplace would breed harmful uncertainty that is counter-productive to achieving reforms. We are also concerned that a federally-established body asserting federal powers to preempt state consumer protection laws could become controversial, as with OCC's preemption of state predatory lending laws for banks. Congressional policy oversight is very helpful to state officials trying to resolve national issues, but federal administrative intrusion could be detrimental. An alternative process that worked recently was the NAIC's successful certification of NARAB compliance by states, as set forth in the Gramm-Leach-Bliley Act. While we are willing to talk and explore ideas, the NAIC believes the concept of direct federal oversight of state regulation must be approached with great caution.

Additional Input

Chairman Oxley asked NAIC to provide input on additional issues that should be part of a national insurance regulatory modernization effort. We are actively engaged in continuous improvement of our state regulatory system in several very important areas that are not mentioned in Chairman Oxley's specific goals set forth above. Many of these involve efforts to improve consumer protection and education for individuals and families who purchase insurance. Adding these goals to the Committee's agenda could strengthen and broaden the appeal of any legislative effort made by the Financial Services Committee. Our research shows that consumers across the country want national protections that establish standards for fair treatment by insurers, but they also want each state to maintain its ability to provide further protections based upon local needs.

Conclusion

The NAIC appreciates this opportunity to offer its input to Congress. However, all we have seen or discussed at this point are general concepts and goals, which we largely support. It is not possible for NAIC or anyone to clearly comment or support specific legislation in a very complex area such as insurance regulation until the actual language of a bill is available to review and analyze.

We understand very well that the "devil is in the details" on insurance legislation because we constantly deal with it in developing NAIC models and working with our state legislatures back home. However, we look forward to fully participating in the process as these issues are considered and discussed. Insurance regulatory modernization and protection of our fellow insurance consumers are not, nor should they ever be, mutually exclusive notions. We can and must achieve both these important objectives.

Statement

of the

Property Casualty Insurers Association of America

to the

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

March 31, 2004

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to present its views on insurance regulatory reform. PCI, the nation's premier property/casualty insurance trade association, was formed in January 2004 through the merger of the National Association of Independent Insurers (NAII) and the Alliance of American Insurers (Alliance), both of which have long histories of association with the subcommittee. The mission of PCI is to foster a competitive insurance marketplace for the benefit of insurers and consumers and to provide a responsible and effective voice on public policy questions affecting insurance products and service.

PCI's members write $154 billion in annual premiums, or 38 percent of the nation's property/casualty insurance. Member companies range in size from billion-dollar national companies to multi-line regional groups to single-state and niche/specialty writers. They include mutuals, stock companies, reciprocals, surplus line carriers and risk retention groups. PCI represents the broadest cross-section of insurers of any national trade association.

PCI members transact most types of property/casualty insurance business, using every type of distribution system. Our members are domiciled in 49 of the 50 states, write coverage in all states and the District of Columbia, and have facilities, employees and policyholders spanning the country. This diversity in membership provides PCI with a unique perspective on insurance regulation.

While PCI members serve a wide variety of personal and business insurance consumers and market their products in many different ways, our companies share the same common vision that competition and market-oriented regulation are in the best interest of the industry and the customers they serve. As reflected in our mission statement, PCI's primary goal in pursuing regulatory modernization is to promote competitive markets and ensure reasonable, efficient and effective regulation.

PCI member companies strive to provide the highest quality products and services to the nation's insurance consumers. Consumers deserve a marketplace that reflects their needs and lifestyles, adapts to changes throughout the years and affords the greatest possible range of choices, while protecting policyholders against insurer insolvency and fraud. PCI member companies support a regulatory environment that allows insurers to offer varied policy choices at a competitive rate. Insurers must also have the ability to adjust policy terms, pricing structures, delivery channels and customer service methods to meet consumer demands and expectations.

PCI members agree with the large majority of insurers, agents, regulators, state legislators and members of Congress that the current insurance regulatory system must improve. Meaningful reforms, which reflect the way business is conducted and are adaptable to the changing business environment, must be adopted. Current regulatory systems frequently cause delays in new product offerings for consumers and impose needless, and costly, rate approval processes. In some states, the company and agent licensing processes are also lengthy and cumbersome. Conversely, in other states, the market withdrawal process is bureaucratic and punitive in nature. Financial and market

conduct examinations are often disjointed and inefficient, and suffer from a lack of coordination. These areas of state regulation must be improved and simplified, and greater uniformity must be achieved. Subcommittee Chairman Richard Baker (R-La.) has proposed a series of federal initiatives designed to address these crucial issues.

PCI commends Chairman Baker for his dedication to improving insurance regulation. The subcommittee has conducted more than a dozen hearings and roundtables examining the regulatory environment and determining areas for reform. Throughout the process, the overriding theme of testimony from a wide array of witnesses is the substantial benefit to consumers of competitive insurance markets.

NAII and the Alliance, along with our member companies, were appreciative of the opportunity to participate in the subcommittee's examination and PCI is pleased to continue to offer its views here today. Rather than address specific components of Chairman Baker's outline, PCI is pleased to offer comments on the scope and direction of the chairman's proposal and the association's general policy position on regulatory reform issues.

PCI recognizes Chairman Baker's goal of strengthening and improving the state regulatory system. First and foremost, PCI believes that the greatest chance to achieve this goal, both politically and functionally, is a narrowly targeted package designed to address the core problems of the current regulatory system – namely antiquated price controls that impose barriers to market-based pricing systems. While other areas of reform are important, the single most significant element overshadowing all other reform proposals is the goal of insuring a truly competitive marketplace with open rate competition. On behalf of our members and policyholders, PCI urges the subcommittee to place the highest priority on competitive market reforms and focus its legislative effort in this direction.

In addition, PCI urges the subcommittee to reaffirm, as Congress did in the Gramm-Leach-Bliley Act, the doctrine of state regulation of insurance embodied in the McCarran-Ferguson Act as part of any reform measure.

Competitive Marketplaces

A marketplace in which competition is the primary regulator of insurance rates best serves consumers, regulators and insurers. Competitive insurance markets afford consumers the greatest choice among service providers, pricing options and insurance products. PCI fully agrees with full committee Chairman Mike Oxley's observation that "without change, consumers face a world with fewer options, less competition, and less available coverage."

Unfortunately, many states still attempt to control prices by requiring insurance companies to get "prior approval" from insurance regulators before adjusting their rates up or down. This strict regulatory method remains in place because of the political pressure to give the appearance of control over, or reduction of, insurance prices.

However, experience shows that prior approval systems make rates more susceptible to political manipulation and that consumers in states with prior approval regulation ultimately end up with fewer insurance companies to choose from and may pay more for their policies.

Political manipulation of rates can take various forms including outright disapproval of individual company rate filings. Regulators may also disapprove use of particular classification plans, rate factors and even discounts. In some states there are regulatory limits on the differences that can be charged in one territory versus another. This can distort cost-based pricing and lead to subsidies. When regulators prevent insurers from charging policyholders premiums based on rating criteria determined by the insurers, regulators interfere with market freedom. All this political manipulation stifles innovation, leads to higher residual market populations, discourages competition and ultimately hurts consumers.

Nor are laws that provide for file-and-use or use-and-file necessarily a panacea. Often, insurers are unable to use a filed rate for fear that the state might disapprove the rate sometime in the future. Worse, an insurer relying on a filing without the approval from a state might be required to disgorge the difference should the new rate later be disapproved. Thus, when PCI speaks of "prior approval" in these comments, we refer to onerous regulatory controls that can be imposed on any filing system.

Like our predecessor organizations, PCI continues to believe that the most desirable regulation of insurance is that which achieves a competitive insurance marketplace. However, regulatory systems in some states have failed in recent years to adapt to changes in both the industry and the marketplace they oversee. Many state regulatory systems have become bloated and inefficient. The expansion of regulatory requirements combined with the lack of uniformity epitomizes regulatory inefficiency. To achieve the goal of market competition for all consumers, regulatory impediments must be eliminated. PCI believes that regulatory rules, procedures and philosophies should be directed toward stimulating market competition, not impeding it, and insurance regulatory systems should be structured to encourage the natural infusion of private capital into the industry.

Regulation of rates and forms is the most critical element of insurance regulatory reform for the property/casualty industry. Excessive governmental interference and control in the development of rates and forms are the prime drivers of the call for regulatory modernization by property/casualty insurers.

PCI supports open competition rating laws as the most desirable approach to rate regulation for the entire industry. Studies verify that consumers in states where competition is the primary regulator of price benefit from expanded choice, innovative pricing and improved insurance availability.

Therefore, PCI supports pure competition-based regulatory systems, as exemplified by the Illinois model. For example, Illinois, which has had competition-based rating since 1971, has an exceptionally healthy personal lines insurance market. Many insurers

compete for business in all parts of the state – including major urban areas. In fact, there are 224 insurance companies domiciled in Illinois alone, while more than 500 carriers write auto insurance. Without a doubt, the open competition rating law has worked successfully for Illinois consumers. Given its population size and concentration, traffic density, housing values, and other factors affecting losses, Illinois would normally be expected to rank among the top ten states for insurance costs, yet it repeatedly remains in the middle range among all states for auto and homeowners prices. In addition, the auto assigned risk pool comprised of consumers who, because of poor loss histories, cannot find insurance in the standard market is extremely low: one-tenth of one percent. Consumers in every state would similarly benefit from the adoption of competitive market systems.

While Illinois has a long history with competitive markets, more recently South Carolina has shown that competitive market reforms produce significant benefits for consumers. In 1999, the state abandoned its prior approval system. Since this change, 105 auto insurers have entered the market, average auto insurance rates have decreased and the state's residual market plan has declined to fewer than 600 drivers, compared to the more than 750,000 drivers it serviced less than a decade ago. The end result is that the system is more fair and responsive and meets the need of consumers, regulators and insurers.

These examples stand in stark contrast to the experience of consumers in other states, such as Massachusetts. The subcommittee has heard extensive testimony on the regulatory failures of the Massachusetts system and the consequences to consumers. This state has a poorly working regulatory system which includes excessive regulation of rates, forms and underwriting that has discouraged new companies from entering the market and led to a decrease in choices available to consumers. By law, the insurance commissioner in Massachusetts mandates rates that must be utilized by all insurers, with only limited deviations permitted. In addition, state statutes prescribe the precise form of coverage that must be made available to all consumers. This over-regulation in the state has driven insurers out of the market and caused unprecedented growth in the residual market. Moreover, the regulation of the residual market itself has worked to deny consumers choice by driving away carriers.

As evidence of Massachusetts' regulatory failure we need only look to the number of insurers domiciled or operating in the state. The number of domiciled companies is one of the lowest in the country. Moreover, the number of licensed auto insurers is 45 percent lower than the average number of auto carriers doing business in the states throughout the nation. Given the state's number of drivers, this quantity is remarkably low and very disconcerting. As a result, the Massachusetts Commonwealth Automobile Reinsurers (CAR) system, which distributes high-risk policyholders among participating companies, remains a concern in this state. CAR and the accompanying state-established rate process have produced a non-competitive market with a disproportionately low number of auto insurers doing business in the state and an unhealthy concentration of business among only a handful of writers.

Opponents of competition-based rating have the misguided impression that a prior approval system keeps insurance rates down. In fact, it is competition that keeps rates down. Prior approval systems require regulators to inefficiently use their time to review and approve rates that are governed by competition and have adverse consequences for consumers, when that time would be better spent in solvency review to assure that the promise is met.

PCI encourages the subcommittee to take an aggressive position with respect to rate and form regulation and to make this element the prime focus of any reform effort. To improve insurance regulation for consumers, regulatory half-measures are not as effective as comprehensive rate regulatory reform for all property/casualty lines. Attempts to enact "stepping stone" systems will not provide the tangible benefits to consumers of pure competition based models. To ensure the fullest benefits to consumers across the nation, PCI strongly urges the Chairman and members of the subcommittee to insist on inclusion of the strongest open competition provisions in any reform legislation.

Similarly, form regulation should be based on market principles. Innovation should be encouraged by any regulatory scheme. Form filings also should be competitively based, i.e., informational only. The objectives of achieving regulatory modernization on forms are the same as for rates: choice, convenience and innovation. External factors driving insurance market conditions affect insurance contracts as much as insurance pricing. Property/casualty insurers must be able to bring new products to market and adjust previously introduced contract forms to market changes and conditions in an expedient manner.

Unfortunately, the current filing and approval processes among states are often quite different and introduce unnecessary complexity, delay and cost for property/casualty insurers. Inefficiencies in the system stifle product innovation, reduce competition and increase costs to consumers. Form regulation, like rate oversight, should be predicated on the concepts of information and disclosure. The goal of form regulation should be to ensure consumer access to information and facilitate development and marketing of new products.

To ensure effective and competitive markets, it is necessary to guarantee access by all insurers to credible data, including companies that operate as single-state insurers, or regional writers transacting business in a limited number of states. Because of smaller books of business, these companies are not always able to develop actuarially credible rating information through their internal loss experience alone. They depend on the availability of aggregated prospective loss cost data in order to develop rates. Without this loss cost information, these companies would be unable to compete effectively with companies who serve these markets, limiting consumer choice. Furthermore, a start-up insurer or an insurer entering a line of business for the first time will not have any credible data of its own to utilize. Access to loss data is critical for market entry.

In addition, many property/casualty insurers (both large and small) rely on the availability of supplemental rating information developed by licensed advisory

organizations such as the Insurance Services Offices (ISO) to price their products. This advisory information would not be available if all insurance companies do not report data or are constrained from reporting data as the result of antitrust law exposure. The McCarran-Ferguson Act provides a limited antitrust exemption under which statistical agents can collect data, and insurance companies can pool and use aggregated loss data.

The availability and reliability of loss cost data is essential to the effective operation of competitive insurance markets. In the absence of such data, all but a few insurers would confront increased operating expenses. Access to accurate and reliable data would become a barrier to market entry. Over time, it could threaten the small company franchise, prevent new entrants into the insurance industry and have a chilling effect on the ability of existing insurers to expand into new markets or new product lines, ultimately reducing consumer choice.

It is imperative that any reform proposal retain the antitrust exemption for loss cost data and continue to require the submission of data by all insurers.

Additional Market Reforms

In addition to the competitive market provisions of the proposal, Chairman Baker has identified a number of areas for reform including market conduct, company and producer licensing and elimination of desk drawer rules. As we have previously noted, these other areas of reform are important, but their impact on improving the insurance marketplace pales in comparison to the value of competitive market reforms. We commend Chairman Baker for proposing additional procedural reforms, but encourage the committee to focus its efforts on rate and form reforms.

We appreciate the chairman's efforts to pursue a coordinated system of standardized market conduct review based on market analysis to identify patterns of abuse and on-sight review of company systems and controls. PCI believes that market analysis must be the cornerstone of any market conduct action to allow states to target their limited resources on the most significant problems. It is also imperative that the standard for review in any market conduct action must be the laws and regulations in effect at the time of the conduct being examined. It is illogical and unproductive to attempt to examine insurers for compliance with rules and regulations that did not exist during the period of the examination. To address problems in the current market conduct examination system, it is also essential that insurers be provided with effective due process protections, including independent arbitration procedures.

With respect to licensing, PCI believes that important reforms of producer licensing laws are necessary and achievable. In response to prior congressional action, many states have moved toward reciprocity; however, failure to participate by several large-market states has reduced the efficiencies hoped for with the adoption of the federal standards. There is broad support among producers, carriers, consumers and regulators to take the next steps beyond the mandates of Gramm-Leach-Bliley and move toward a national approach to ensure full reciprocity for producer licensing across all 50 states in producer licensing. From a company licensing perspective, varying state standards can serve as a market

entry impediment. It can take a company wishing to become licensed in all 50 states over a decade to complete the process. These delays reduce markets for new products, impede competition for products and limit consumer choice. As a result, PCI supports efforts to streamline market entry.

Another particular area of frustration and concern for PCI members is the existence of regulatory rules that have not been codified or formally adopted through regulatory proceedings, often referred to as "desk drawer rules." Insurance companies are not in a position to know what the desk drawer standards are in advance of their application for a license or rate or form filing, nor are they kept abreast of revisions, should they occur. In fact, the authority for these standards is often lacking or questionable. Application of these unpublished and unpredictable procedural requirements often serve as barriers to market entry and thwart the efforts of insurers to offer new products and services for consumers. Furthermore, it is impossible for insurers to make meaningful business and operational decisions when they are in danger of violating unwritten rules. Chairman Baker proposes to eliminate these so-called "desk drawer" rules. PCI supports efforts to outlaw such inefficient and arbitrary obstacles to effective market operation, but suggests that the most efficient way to eliminate "desk drawer" rules is by implementation of competitive market principles. By definition, there can be no desk drawer rules for rates and forms in a competitive market.

Role of the NAIC and Federal Government

There is no clear consensus among the property/casualty industry on the appropriateness of a federal supervisory or management role in insurance regulation. While a significant segment of the industry supports the adoption of an optional federal charter approach to regulatory modernization, the majority of main street insurers are reluctant to cede any form of regulatory authority to the federal government or to a non-governmental institution such as the National Association of Insurance Commissioners (NAIC). However, all agree on one thing and this is that the greatest threat to efficient markets is dual or multiple layers of regulation. Creating new oversight institutions or layers of reporting will drive up the cost of insurance products, make it harder for smaller companies to compete and ultimately reduce consumer choice. As a result, attempts to unnecessarily expand the regulatory or oversight role of the NAIC or to create a new and duplicative layer of quasi-regulatory authority at the federal level are almost certain to introduce needless controversy into any reform measure.

Conclusion

PCI is pleased that Chairman Baker and the subcommittee have taken an active interest in pursuing targeted state insurance regulatory reforms. We share the goals of the committee of developing a more competitive marketplace, providing better availability of insurance and expanding coverage capacity for consumers.

While PCI supports the general reform concepts, the specific details of the final proposal will be determinative of the level of support of PCI member companies. On behalf of our

over 1000 members, we look forward to working with the committee to modernize and improve the state insurance regulatory system.

STATEMENT OF

J. ROBERT HUNTER,

DIRECTOR OF INSURANCE

BEFORE THE

CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
SUBCOMMITTEE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

"WORKING WITH STATE REGULATORS TO INCREASE INSURANCE CHOICES FOR CONSUMERS"

MARCH 31, 2004

Good morning, Mr. Chairman and members of the Subcommittee. I am Bob Hunter, Director of Insurance at the Consumer Federation of America. I formerly served in the federal government as Federal Insurance Administrator under Presidents Ford and Carter and as Texas Insurance Commissioner.

Attached to my statement is a letter signed by over 80 groups representing consumers, labor organizations, low-income Americans, housing groups and minorities. These groups include Consumers Union, the AFL-CIO, and a variety of state-based organizations. We have all asked Chairman Oxley to reconsider his road map for legislation to override state regulation of insurance.

Background

As I understand the road map proposed by Chairman Oxley in his comments to the National Association of Insurance Commissioners (NAIC), Congress would establish uniform standards for certain aspects of insurance regulation that the states would be required to enforce, "without deviations."[1] Among the areas that would be preempted is price regulation, which is termed "deleterious" to consumers, as well as the licensing of insurers and agents. Furthermore, an Interstate Compact would be required to be adopted by all states regarding some lines of insurance. Uniform market conduct exams would be required under the provisions of the recently adopted model proposed by the National Conference of Insurance Legislators (NCOIL). Certain other model bills proposed by the NAIC and/or NCOIL might be required to be adopted nationwide. Under a "choice of law" requirement, property-casualty policies for large, multi-state companies would only be regulated by the state in which the company is domiciled.

A Federal-State Advisory Council would be created, not to regulate but to coordinate to "see that these reforms are implemented" by all states.

The End of Federalism – With No Explanation of How this End is Achieved

"Intransigent" state legislatures would be cut out of the process, because Chairman Oxley has stated that "we can't rely on all 50 state legislatures to adopt exact uniform compliance." State Insurance Commissioners would become mere federal functionaries in preempted areas, acting as tools to carry out federal edicts. Chairman Oxley would take this preemptive approach despite his praise for the states as "laboratories for reform" and as "more responsive to the local marketplace as well as to local consumers."

The standards proposed in the road map are startling in their anti-federalist sweep. They do away with decades of deliberations by state legislators, largely eliminating their role in the preempted regulatory areas. This road map would even override the vote of the people of California in adopting the property-casualty insurance (excluding workers' compensation) regulatory system of Proposition 103 in 1988.

In his comments about the road map, Chairman Oxley states that there would be "no federal regulator." But how would Congress force state compliance with its edicts without the threat of a federal takeover if the states do not comply? Why would, for example, the elected Commissioner of California choose

[1] Comments of Chairman Oxley to the NAIC, March 14, 2004.

to enforce inadequate Illinois-style regulatory standards, the very standards that the voters of California rejected in 1988, in lieu of enforcing the overwhelmingly successful Proposition 103 standards that California voters want? The road map does not say what the "stick" is that will be used by the federal insurance czar to force the commissioners into compliance. Nor does it propose any financial "carrots" to entice a commissioner into enforcing federal standards that would so clearly disadvantage his or her constituents.

A Key Consumer Protection, Price Regulation, Must Not be Preempted

The road map makes a grievous error in overriding all state price controls on insurance. It ignores the differences between insurance and other products and the kind of regulation that is necessary to protect consumers when they are purchasing a complex legal document that is often not needed for many years. (See attached fact sheet, "Why Insurance is an Essential Public Good, not Some Normal Product that Can be Regulated Solely through Competition".)

The road map also does not anticipate crisis situations, for example a hurricane or other natural disaster. In the wake of Hurricane Andrew, Florida found out the value of having tough regulatory powers (and a legislature that could act quickly to put new controls in place) when the state avoided a crisis by imposing strict controls on prices and underwriting decisions in the months after that tragic event.

The road map leaves many insurance consumers vulnerable to predatory pricing and price gouging, while tying the hands of states that want to eliminate these abuses. These vulnerable consumers include small business owners, low and moderate-income consumers and minorities. Small businesses in low-income areas will be vulnerable to redlining. All small businesses will be at risk of price spikes during the hard market phase of the well-documented insurance cycle.

The kind of deregulation envisioned in the road map assumes that rate regulation and competition are mutually exclusive. They are not. California's auto insurance regulatory system has powerfully demonstrated the utility of maximizing both competition and prior approval of insurance rates for the benefit of consumers. On the other hand, the deregulation of California's workers compensation system has produced a crisis that Governor Schwarzenegger is dealing with this week. In Texas, the deregulation of the homeowners insurance system has caused a meltdown in the stability of prices in that state. (The attached fact sheets explain why regulation of insurance is necessary and why regulation and competition can work well together.)

In contrast, Chairman Oxley has pointed to Illinois as a regulatory model for the road map. There are very few states that have fewer protections for consumers. For instance, Illinois does not regulate rates at all. In fact, the Illinois system is not really a system. It is a non-system, created when the Illinois legislature became deadlocked and the requirements of the existing regulatory system expired under a sunset provision.

Since 1989, auto insurance rates have risen by 35 percent in Illinois (versus 30 percent nationally), while California's rates have ***fallen*** by 8 percent. Prior to adopting the new system voted in by the people of California in Proposition 103, California had the very deregulatory system that the road map now proposes to reinstate.

Americans deserve better than "least common denominator" consumer protection; they deserve the best. After intensive study, CFA has determined that the California system of regulation is the best in the nation (see "Why Not the Best?" At www.consumerfed.org). If you go forward with this road map, we urge you to use the nation's best system, not its worst, as your model.

Classifications – Redlining

A critical aspect of rate regulation is the approval of classifications. For instance, many states have moved to ban or limit the use of credit scoring, redlining by territorial definition and control of the use of other criteria that disadvantage poor people and minorities. All of these types of restrictions would be eliminated by the road map approach. Thus, insurers would be free to use whatever classes they choose: credit scoring, new territories, human genome information to determine who gets life insurance or Global Positioning System data to track the number of miles policyholders drive and where they go -- all with no oversight by states.

States would become helpless to stop redlining and abusive classification systems. They would also be helpless to enforce state consumer protections that might exceed the federal dictates.

Single Choice of Law

Under the road map, businesses would benefit from a single choice of law. As Chairman Oxley stated, "If Microsoft is purchasing liability insurance, the State of Washington would have the greatest interest in protecting the company." If the state of Washington has the greatest interest in pleasing Microsoft, this could often be to the detriment of its residents and consumers across the country. This proposal could provoke state competition to place further restrictions on the legal rights of consumers across the country, as states rush to please large corporations with tremendous economic clout that are based in their states.

Fear of Federal Regulation Has Already Caused Harm to Consumers

Members of the Subcommittee should be aware that the keen interest some members of the Financial Services Committee have shown in state insurance regulation has already led to regulatory changes by some states and the NAIC. However, many of these changes have not been positive for consumers. The NAIC has moved to eliminate inefficiencies and delays in product approval that were inherent in the system, which is positive. Consumers do not want inefficient regulation since they pay for it. Indeed, consumer groups were instrumental in helping to identify regulatory inefficiencies and in proposing reforms to eliminate them, including a 30-day limit for states to act in approving commercial rates and policy forms.

However, insurers have used this Congressional interest to push the states beyond cutting fat into cutting the muscle of needed consumer protections. Some states have rushed to deregulate commercial insurance and, in the rush to head off federal intervention, have left very small businesses, which are frequently not sophisticated buyers of insurance, exposed to abuse. Indeed, of the 5,667,774 firms in America, fully 60 percent (3,401,676) have fewer that five employees. Some states have even moved to deregulate personal lines of insurance, as South Carolina now proposes to do in home insurance and

as a draft bill in Florida regarding automobile insurance. The NAIC has recently dusted off a proposal to deregulate personal lines and will be considering it once again.

States are doing this not because they necessarily think it proper, but because they have been told by insurers that this is the only way to keep them on board to head off an imminent federal takeover of insurance regulation. It is crucial that this Subcommittee send a signal to the states that mindless deregulation will harm millions of consumers and small businesses across this nation.

Improving Competition While Protecting Consumers

Any serious attempt to increase competition in the insurance industry and better protect consumers must take into account the differences that exist between insurance and other products. These differences require that many steps be taken to ensure that free markets function well, including:

- Some degree of imposed uniformity (of insurance forms) is necessary for consumers to understand and compare the complex legal document that is the insurance policy. This allows consumers to shop with the assurance that the products they are comparing are actuarially equivalent. The road map does not appear to require uniformity of forms, only uniformity in how forms are approved.

- Better information about policy prices, the level of service provided by insurers and their financial soundness must be provided to consumers if competition can succeed in spurring lower prices and better quality policies. The road map does not require better consumer information.

- Insurers should be prohibited from misusing classification information, such as credit scoring, or from misusing similar information in the future, such as human genome data for life insurance, or Global Positioning System information to track drivers for auto insurance rate purposes. By preempting state rate regulation, the roadmap will also block state prohibitions on the abusive use of classification information.

- Insurers should be prohibited from "redlining" in certain territorial designations, and other practices that prey upon the poor. By preempting state rate regulation, the road map will also block state prohibitions on redlining.

- Insurers should be required to take steps to help consumers afford the purchase of a mandated product. If insurance rates go up, demand does not decrease. Insurance demand is inelastic because states require auto insurance and lending institutions require home and other forms of insurance. If competition is to be fully effective, mandates must be balanced with measures that help consumers to afford insurance coverage, perhaps by requiring limits on underwriting such as mandated offers of insurance to good drivers and to home or business owners who meet building codes requirements. By preempting state rate regulation, the road map will make insurance harder to afford for many small businesses and consumers.

Improving Competition and Bringing Down Rates for Businesses: Expanding the Liability Risk Retention Act

In the last two years, high rates for property-casualty insurance have been a serious problem, especially for mid-sized and larger firms. Moreover, insureds of all sizes have experienced rate gouging. The rate problem is caused by a classic turn in the economic cycle of the industry, which has been accelerated by--but not caused by--the terrorist attacks of September 11th. By expanding the Liability Risk Retention Act, Congress would be spurring the creation of private alternatives to the over-priced insurance that still exists today and that occurs in all hard insurance markets.

The Product Liability Risk Retention Act of 1981 was developed by Congress as a direct result of the product liability insurance hard market of the mid-1970s. The current version of the Act, the Liability Risk Retention Act of 1986,[2] was passed to expand the Act to all commercial liability coverages as a direct response to the hard market of the mid-1980s. It allowed businesses to join together to form purchasing groups to buy liability insurance as a unit or to form self-insurance combinations by getting approved in only one state.

The National Association of Insurance Commissioners describes the RRA as follows:

> The purpose of the RRA is to increase the availability of commercial liability insurance which became severely restricted in the market crisis of the mid-1980s...An RRG[3] is a risk-bearing entity that must be chartered and licensed as an insurance company in one state...Once the group has obtained a license, it may operate in all states...and is regulated almost exclusively by the domiciliary commissioner...The RRA requires that the RRG be owned by its insureds and requires the insureds to have similar or related liability exposure. The only type of coverage an RRG is permitted to write is commercial liability insurance for its members and reinsurance with respect to the liability of any other RRG...A PG[4] may purchase only commercial liability insurance for its members...[5]

The creation and expansion of the RRA helped overcome the problems of the two previous hard markets and would do so again in the current hard market. Not only would expansion of the Act enable businesses to get together to cover other risks, but this option would also put pressure on the insurance industry to stop price gouging or risk losing market share.

Expansion of the RRA to cover property damage could also help companies, especially small and mid-sized firms, to insure against future terrorism losses. Even firms, office buildings and public facilities with high exposure to terrorism risk could benefit. Expansion of the RRA to cover property would offer airlines, for example, and similar insureds, the opportunity to spread risk and cover potential terrorism losses from property (e.g., the airplane hull) as well as liability.

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[2] 15 USC §3901 et sec.
[3] RRG is a Risk Retention Group operating under the RRA, the Risk Retention Act.
[4] PG is a Purchasing Group.
[5] Risk Retention and Purchasing Group Handbook, NAIC, 1999, Pages 11-13.

Improving Uniformity of Regulation While Protecting Consumers

CFA has offered a number of proposals that, if implemented nationally, would improve uniformity of regulation and protect consumers. (Attached are recommended consumer principles and standards for insurance regulation.) However, the implementation of national standards should not be done in a way that stifles state regulatory innovation or that undermines the need for state or regional regulatory variations. After all, there are still many state or regionally based insurers. Insurance risks can obviously vary by region as can specific problems that spur insurance claims. If consumers in Texas are having problems with mold, Texas regulators should have free rein to place specific requirements on insurers that sell homeowners insurance in their state – including national insurers. This is why CFA supports minimum national standards that would put insurers and consumers on a "level playing field." This would improve uniformity of regulation and better protect consumers, while allowing states to exceed minimum standards to meet the specific needs of their residents.

Some of the model bills proposed by NAIC and NCOIL would provide adequate minimum consumer protections at the national level. However, much of this legislation, which is heavily influenced by insurers, would not protect consumers. CFA would support the elimination of countersignature laws in the states that still have them, because these rules are vestiges of an earlier non-competitive era and only protect insurance agents from competition from other, more efficient agents in other states. CFA would also support deregulation of property-casualty rates for truly large commercial interests, as NAIC and NCOIL have proposed, but only if such deregulation doesn't affect small and medium sized businesses that can't afford risk managers to negotiate for them. We would also consider endorsing the NCOIL market conduct model bill as a national minimum standard if it is strong enough, once NAIC finalizes its review.

Insurer Profits

In his comments about the road map, Chairman Oxley expresses concern about a "substandard return on equity among (property/casualty) insurers" with a "marketplace…at risk for a major collapse." There is no chance of this happening.

First of all, property/casualty insurance is not a high-risk business requiring a high return. The risk of insurance can be diversified through reinsurance and other risk-sharing/spreading mechanisms. The proof of this is that, although returns are historically "low," stock market returns are quite good for the leading writers of property/casualty insurance. The per share book value for Berkshire Hathaway has risen by twice the rate of the Standard & Poors 500 since 1990, according to Warren Buffet's current report to shareholders. Allstate's share value has more than tripled since 1990; Berkshire's share price is up tenfold and AIG's share price has risen more than seven fold.

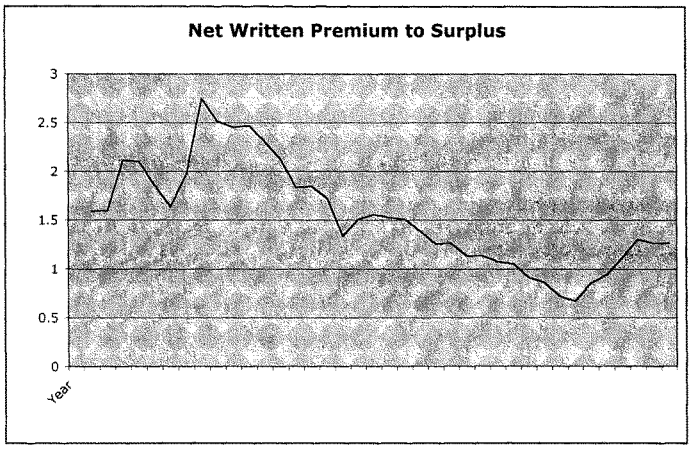
Second, the property/casualty insurance business is cyclical. Profits sink during the more competitive "soft," phase of the cycle and rise sharply during a hard market. The profits are excellent now, and are expected to remain good for some years to come, as the industry ends its hard market phase.

The top five stock insurance groups in the nation are Allstate, AIG, Zurich, Berkshire Hathaway and Travelers, with written premiums of $23.3 billion, $21.0 billion, $17.4 billion, $15.2 billion and $11.9 billion respectively. (State Farm, the nation's largest insurer at $42.7 billion, is a mutual insurer.)

Consider the outstanding profits of these insurers in 2003:

Allstate	$2.3 billion (16.5% ROE)
AIG	$9.3 billion (17.2% ROE)
Zurich	$2.1 billion (12.5% ROE)
Berkshire Hathaway	$8.2 billion (16.2% ROE)
Travelers	$1.7 billion (17.4% ROE)

Third, the most common test of the financial solidity of the property-casualty insurance industry is the ratio of net premiums written to surplus (retained earnings). Here is how that key ratio has performed over time:



As the chart reveals, the ratio has declined, generally, over time. During the recent soft market it rose from under 1 to 1 to about 1.3 to 1, still very safe by historical ratio standards. The recent increase in the ratio has now stabilized and, if past history of the years following a hard market is a guide, will start dropping again shortly. The historic safe level, known as the "Kenney Rule" for the financial writer Roger Kenney, is 2 to 1. Commissioners get particularly concerned if the ratio approaches 3 to 1.

The industry is doing very well and is fundamentally very sound. There is no impending crisis.

But, even if there were a need to increase the profits of the property-casualty insurance industry, why choose the Illinois system to do that? The profit of insurers in Illinois was just below the national average over the decade 1994-2003. Massachusetts, which has a system of rate regulation that Chairman Oxley would likely oppose, had profits of over 12 percent during that period, compared to Illinois' 7.5 percent and the nation's 7.7 percent. California's auto insurance profits were almost 60 percent higher than the Illinois profits despite the amazing drop in premiums California consumers enjoyed over this time period.

Conclusion

On behalf of all the groups that signed the letter attached to this testimony, I ask that this subcommittee not move forward with this ill-advised road map concept. We are more than willing to work with the members of the Subcommittee and state regulators on proposals that will improve uniformity of regulation and the speed with which insurance products are brought to market -- without sacrificing consumer protections. Unfortunately, the road map does not achieve this balance.

Consumer Federation of America

March 26, 2004

The Honorable Michael Oxley
Chairman, Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Opposition to Insurance Road Map

Dear Mr. Chairman:

The over 80 undersigned consumer, low income, housing, minority and labor organizations from throughout the country strongly urge you to reconsider your decision to offer legislation that will override state regulation of insurance rates. This unprecedented federal intrusion into state insurance regulation would leave millions of consumers vulnerable to price gouging, as well as abusive and possibly discriminatory insurance rating practices. It would also open the door to a return to insurance redlining, as deregulation of prices would include the lifting of state controls on territorial line drawing. States would also be helpless to stop the misuse of "risk classification" information for pricing purposes, such as credit scoring, territorial data, and the details of consumers' prior insurance history.

Our concerns with this proposal are not just with the elimination of rate regulation. For example, the "choice of law" provision – which would only allow the state of domicile of commercial policyholders to regulate the terms of these policies -- could provoke state competition to place further restrictions on the legal rights of their residents, as states rush to please large corporations with tremendous economic clout that are based in their states.

State insurance regulation is also critical to business and labor, particularly in workers' compensation. Every business must purchase workers' compensation insurance. Without rate review, businesses are overwhelmed with premium increases every time the insurance underwriting cycle turns to a hard market. California and Florida are but two examples of the crisis that occurs without effective regulation. States with effective regulation, such as Massachusetts and Virginia, have avoided these hard market crises. Effective state regulation must be expanded, not eliminated.

This proposal shows a fundamental misunderstanding of the way the insurance marketplace works. Insurance is an essential public good, not just any product that can be regulated solely through free market competition. Insurance policies are exceedingly complex legal documents. Most consumers can't look at an insurance policy and tell for sure whether they have a good one. Comparison shopping is very difficult because the amount, type and pricing of coverage can vary greatly. Once a policy is purchased, the test of its effectiveness

may not arise for decades, when a claim arises. (Please see the attached fact sheet for more information on why insurance is not a normal product for the purposes of regulation.)

Relying on competition alone to control insurance prices and prevent abusive products is ineffective and dangerous for consumers. Insurers can maximize profits by denying older and sicker people health insurance or by denying inner city residents home and auto insurance. Price structures include "classifications" which need governmental review for fairness and relevancy. Most insurers use credit scoring for insurance rating, which segregates out poorer people for denial or for higher prices. Some insurers now want to use the human genome to price life insurance, and Global Positioning Satellites to track consumers in order to price auto insurance. Regulation is required to control classification abuses – the number of potential "innovative" class systems that violate consumer rights and privacy is quite large. Information is also needed to police these abuses, such as zip code data to see where insurers are writing business and how much people are paying for insurance. (Please see the attached fact sheet on why effective regulation– not regulation solely through competition is needed in the insurance marketplace.)

You have cited the Illinois insurance regulatory system as a model for your federal intervention. There are very few states in the country that have fewer protections for consumers. For instance, Illinois does not regulate rates at all. Consequently, insurance rates have been shooting up sharply in Illinois compared to California, where voter-approved Proposition 103 has led to both tight rate regulation and vigorous insurance competition. Since 1989, auto insurance expenditures are up by 35 percent in Illinois and by 30 percent nationally. In California, they have dropped by eight percent. (See CFA's comprehensive study of the California system, "Why Not the Best?" on our website, www.consumerfed.org).

Another state that has been cited by you and by insurers as a deregulation model is South Carolina. We attach an analysis of the insurance situation in South Carolina since it deregulated insurance. Please note that the auto insurance rates in South Carolina are up, not down, since the law passed in 1999 and that South Carolina's rates have risen faster than California's.

The insurance industry promotes a myth that regulation and competition are incompatible. This is demonstrably untrue. Regulation and competition both seek the same goal: the lowest possible price consistent with a reasonable return for the seller. There is no reason that these systems cannot coexist and even compliment each other. The California insurance regulatory structure is a remarkable synthesis of effective regulation and competition. (See the attached fact sheet on how competition and regulation can work well together.)

When you presented your ideas on federal intervention to the National Association of Insurance Commissioners on March 14, 2004, you stated that there was a "capacity squeeze" in the insurance industry and that insurer rates of return (ROR) were too low. This is disputable, as some economists have stated that the markets work to produce the proper RORs and that the insurance industry does not need a high level of ROR due to its ability to diversify its risk through reinsurance and other means. However, if you are right, you seem to be saying that rates have been too low and that your intent is to let rates rise. Your solution to move to an Illinois system is remarkable, given that the returns in Illinois over the last decade for all property-casualty lines have been slightly less than the national average you claim is too low.

This extreme proposal is grievously flawed. It would override state laws that guarantee fair pricing and open the door to some of the worst insurance abuses that have occurred in the

last thirty years, such as redlining. It would then tie the hands of states in addressing abuses that are occurring right now and might occur in the future, like the misuse of credit scoring and human genome information for insurance purposes. The consumers who are most vulnerable to the harm that it would cause are our nation's most vulnerable: the oldest, the poorest and the sickest.

We strongly urge you to reconsider your decision to move forward with this dangerous proposal.

Yours truly,

J. Robert Hunter
Director of Insurance

AFL-CIO
Alabama Watch
Arizona Consumers Council
Asian Law Caucus
Association of Flight Attendants
California Association of Local Housing Finance Agencies
California Coalition for Rural Housing
California Community Economic Development Association
California Housing Authorities Association
California PIRG
California Reinvestment Coalition
California Rural Legal Assistance Foundation
Center for Economic Justice
Center for Insurance Research
Center for Justice & Democracy
Center for Medical Consumers
Center for Public Interest Law
Civic Center Barrio Housing Corp.
Citizens for Consumer Justice (PA)
Citizens' Health Advocacy Group
Coalition for Consumer Rights (Illinois)
Colorado PIRG
Columbia Consumer Education Council
The Committee for Justice for All
Community Housing Developers, Inc.
Community HousingWorks
Concerned Clergy Coalition of Kansas City, MO
Connecticut PIRG
Consumer Action
Consumer Federation of America

Consumers for Auto Reliability and Safety
Consumers Union
Brenda J. Cude, Funded Consumer Representative
to the National Association of Insurance
Commissioners, and Professor, University of Georgia
East Bay Community Law Center
East Bay Habitat for Humanity
Fair Housing of Marin
Florida Consumer Action Network
Foundation for Taxpayer and Consumer Rights
E. Thomas Garman, Ph.D., Professor Emeritus,
Consumer Affairs, Virginia Polytechnic Institute
Greater Rochester Community Reinvestment Coalition
Homeowners Against Deficient Dwellings (HADD)
Illinois PIRG
Justice Organizers, Leadership and Treasurers
Maryland Consumer Rights Coalition
Maryland PIRG
Massachusetts Affordable Housing Alliance
Massachusetts Consumers' Coalition
Massachusetts PIRG
Michigan Consumer Federation
Dr. Regene L. Mitchell, Consumer Educator
Multicultural Real Estate Alliance For Urban Change
National Partnership for Women and Families
Neighborhood Economic Development Advocacy Project
New England Patients' Rights Group
New Jersey Citizen Action
New Jersey Consumers for Civil Justice
New Jersey PIRG
New Mexico PIRG
North Carolina PIRG
NYPIRG (New York)
Maryland PIRG
Oregon State PIRG (OSPIRG)
Our Bodies Ourselves (Massachusetts)
Pennsylvania PIRG
People's Medical Society
PIRG in Michigan (PIRGIM)
Public Interest Law Office of Rochester
Rhode Island PIRG
Sacramento Mutual Housing Association
San Diego Advocates for Social Justice
San Diego City/County Reinvestment Task Force
San Diego Housing Federation
Texans for Public Justice
Texas Legal Services Center
Texas PIRG
Texas Watch

USAction
U.S. PIRG
Vermont PIRG
Virginia Citizens Consumer Council
West Virginia Citizen Action Group
Wisconsin PIRG

CC: Representative Barney Frank, Representative Richard Baker, Representative Paul Kanjorski, Robert Gordon

WHY INSURANCE IS AN ESSENTIAL PUBLIC GOOD, NOT SOME NORMAL PRODUCT THAT CAN BE REGULATED SOLELY THROUGH COMPETITION

1. ***Complex Legal Document.*** Most products are able to be viewed, tested, "tires kicked" and so on. Insurance policies, however, are difficult for consumers to read and understand -- even more difficult than documents for most other financial products. For example, consumers often think they are buying insurance, only to find they bought a list of exclusions.

2. ***Comparison Shopping is Difficult.*** Consumers must first understand what is in the policy to compare prices.

3. ***Policy Lag Time.*** Consumers pay a significant amount for a piece of paper that contains specific promises regarding actions that might be taken far into the future. The test of an insurance policy's usefulness may not arise for decades, when a claim arises.

4. ***Determining Service Quality is Very Difficult.*** Consumers must determine service quality at the time of purchase, but the level of service offered by insurers is usually unknown at the time a policy is bought. Some states have complaint ratio data that help consumers make purchase decisions, and the NAIC has made a national database available that should help, but service is not an easy factor to assess.

5. ***Financial Soundness is Hard to Assess.*** Consumers must determine the financial solidity of the insurance company. One can get information from A.M. Best and other rating agencies, but this is also complex information to obtain and decipher.

6. ***Pricing is Dismayingly Complex.*** Some insurers have many tiers of prices for similar consumers—as many as 25 tiers in some cases. Consumers also face an array of classifications that can number in the thousands of slots. Online assistance may help consumers understand some of these distinctions, but the final price is determined only when the consumer actually applies and full underwriting is conducted. At that point, the consumer might be quoted a much different rate than he or she expected. Frequently, consumers receive a higher rate, even after accepting a quote from an agent.

7. ***Underwriting Denial.*** After all that, underwriting may result in the consumer being turned away.

8. ***Mandated Purchase.*** Government or lending institutions often require insurance. Consumers who must buy insurance do not constitute a "free-market", but a captive market ripe for arbitrary insurance pricing. The demand is inelastic.

9. ***Incentives for Rampant Adverse Selection.*** Insurer profit can be maximized by refusing to insure classes of business (e.g., redlining) or by charging regressive prices.

10. ***Antitrust Exemption.*** Insurance is largely exempt from antitrust law under the provisions of the McCarran-Ferguson Act.

Compare shopping for insurance with shopping for a can of peas. When you shop for peas, you see the product and the unit price. All the choices are before you on the same shelf. At the checkout counter, no one asks where you live and then denies you the right to make a purchase. You can taste the quality as soon as you get home and it doesn't matter if the pea company goes broke or provides poor service. If you don't like peas at all, you need not buy any. By contrast, the complexity of insurance products and pricing structures makes it difficult for consumers to comparison shop. Unlike peas, which are a discretionary product, consumers absolutely require insurance products, whether as a condition of a mortgage, as a result of mandatory insurance laws, or simply to protect their home or health.

WHY EFFECTIVE INSURANCE REGULATION IS NECESSARY

There are good reasons why insurance has, historically, been subject to regulation. The most obvious one is that a consumer pays money today for a promise that may not be deliverable for years. That promise must be secured from many threats, including insolvency and dishonesty.

No one seems to dispute the need for oversight of insurer solvency and bad management behavior. Insolvency regulation has been upgraded, thanks in large part to the interest in the issue of Warren Magnusson and John Dingell (which is how insurers first became aware of the value of Congressional pressure on state regulators.)

The big question is: can price and product regulation be eliminated? The insurance companies say "sure," but they never discuss the potential adverse impact on consumers.

Product Regulation

Product regulation is very important for consumers. Consumers cannot be asked to pick out good or avoid bad deals by reading a policy. If insurers are free to write any contract that they want, some sharp dealers will come in with deceptive policies that look good but take away the apparent coverage in the fine print. Competition will develop between insurers to offer poor products that unwary consumers will buy.

Consumers are in no rush to have bad products appear in the market, even though insurers insist that "speed-to-market" is somehow a critical issue. It makes no sense to remove front-end control of these products and wait for market conduct exams or, as is more common, lawsuits, to clean up the mess.[1]

However, consumer groups do want efficient regulation. Consumer organizations worked very hard with the NAIC to eliminate inefficient regulatory practices and delays, even helping put together a 30-day total product approval package. The groups' concern was not with fat cutting, but with removing regulatory muscle when consumers are vulnerable.

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[1] There are several reasons why it is dangerous for consumers if regulators focus too much on "speed to market." They risk overlooking the kind of regulation that has been needed to stop past abuses, such as: life insurance policies with rates of return that insurers did not deliver; consumer credit insurance policies that pay pennies in claims per dollar in premium, and race-based pricing of insurance policies. Second, in some trials of product deregulation in health insurance, policies with low prices often were found to have fine print that eliminated most coverage. Third, standards to ensure fair pricing, adequate disclosure and a more honest marketplace are urgently needed and should be a part of any process for faster product approval, particularly in the era of globalization and Internet sales. Fourth, CARFRA, a voluntary organization set up by the NAIC to offer "one-stop" approval over several states, is dangerous for consumers. CARFRA lacks direct accountability to the relevant public: consumers in affected states. There is no assurance that their standards for product approval will benefit consumers. For example, if a panel made up of Montana members approves a rate or policy for use in California, then it will be difficult for California consumers to object. CARFRA must be an independent, legally authorized entity with democratic processes, such as on-the-record voting, notice and comment rulemaking, conflict-of-interest standards, prohibitions on ex-parte communications, etc. CARFRA cannot rely on the industry it regulates to provide its funding. These same concerns with CARFRA also exist in the interstate compact concept.

Price Regulation

Price regulation is a complex issue. Price regulation considerations vary by line of insurance. Large commercial policyholders have insurance experts, called "risk managers," on staff. They need less help from government. However, individuals and small businesses may need help. They are not well-informed consumers and often go into the insurance purchase decision with an odd combination of fear and boredom. They frequently go to an insurer or agent and say something akin to "take me, I'm yours," a shopping strategy that does nothing to discipline the market price[2].

The degree of insurance regulation that is needed varies by line-of-business, something insurers often don't admit. As an example, consider three life insurance products: term life, cash value life and credit life. As the products are quite different, the regulatory response to these three products must be different.

Term life insurance is easy for consumers to understand. If one dies during the term, whatever that time frame is, one's beneficiaries receive the face amount of the policy. Consumers understand this very well so coverage is not an issue. Dead is dead, so service is not much of an issue compared to, say, auto claims. Solvency may also be somewhat less of an issue, depending upon the length of the term. The main decision consumers face centers on price. Excellent online price services exist.

Because of the simplicity of the decision-making process, term insurance prices are very competitive and have fallen year-by-year for decades. Price regulation is not needed in this line of life insurance.

Cash value insurance is a complex product. It is essentially a term policy with a bank account hidden inside the product. The problem is that the industry has resisted calls for tools to help consumers more easily understand what is going on inside the policy or to create suitability requirements for its agents. It is very difficult to know exactly what part of the first year premium (if any– often, it is none) goes into the bank account. Even actuaries who analyze insurance policies professionally say that they frequently can't tell a good product from a bad one without running the policy details through a computer. Consumers are confused. Competition is weak. Prices have not declined in the way term prices have.

For this product, prices should be subject to more control than exists today unless the industry truly agrees to stop the obfuscation and promote rules that let the consumer see what each policy is truly like.

Credit life insurance is a product sold along with a loan, such as a car loan. The car dealer may offer the coverage that would pay off a loan if an insured consumer dies, so that this person's family would own the car outright. The problem is that consumers do not go to car dealers to buy insurance. They have not even thought about it until the dealer starts the sales pitch. If the consumer decides to buy the coverage, the consumer does not then go out and shop for an insurance company. The dealer has already done that for the consumer.

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[2] Another problem with insurance is the inertia of consumers. That is, the reluctance to change carriers for even fairly large price breaks. Consumers fear that new insurers would be more apt to drop them after a claim than their old insurer. This inertia is a drag on the competitive force of consumer decisions.

Guess what criteria the dealer uses in making the choice of credit life insurer? The amount of the commission is, of course, the decisive factor. (Some car dealers make more money selling insurance than cars.) Prudential Insurance Company once said in a hearing in Virginia that they did not sell much credit life insurance because "we are not competitive, our price is too low."

This purchase-of-insurance-by-the-commissioned-agent-not-the-consumer/buyer has a name: "Reverse Competition." In this line of insurance, competition drives the price up, not down.

Credit life insurance must have price regulation. States have recognized this by limiting the price that can be charged, with widely varying criteria. New York and Maine consumers pay one-fifth of the rate of Louisiana consumers, although Louisianans obviously do not die five times faster than Mainers. Even though the credit life insurers, car dealers and other powerful lobbyists have succeeded in keeping the price outrageously high in most states, at least there are price caps in every state, as there must continue to be.

In other words, a one-size-fits-all deregulation approach to insurance oversight would not deal with the complexity of many insurance products in the marketplace and would be very hazardous to America's consumers.

IS REGULATION INCOMPATIBLE WITH COMPETITION?

The proof that competition and regulation can work together in a market to benefit consumers and the industry is the manner in which California regulates auto insurance under Proposition 103. Before Prop. 103, Californians had experienced significant price increases under a system of "open competition" of the sort Illinois now uses. (No regulation of price is permitted but rate collusion by rating bureaus is allowed, while consumers receive very little help in getting information on the quality of the insurance product, service, solvency and pricing.) Proposition 103 sought to maximize competition by eliminating the state antitrust exemption, laws that forbade agents to compete, laws that prohibited buying groups from forming, and so on. It also imposed the best system of prior approval (of insurance rates and forms) in the nation, with very clear rules on how rates would be judged.

As the Consumer Federation of America's in-depth study of regulation by the states revealed,[3] California's regulatory transformation--to rely on both maximum regulation and competition--has produced remarkable results for auto insurance consumers and for the insurance companies doing business there. The study reported that insurers have realized very nice profits, above the national average, while consumers saw the average price for auto insurance drop from $747.97 in 1989, the year Proposition 103 was implemented, to $717.98 in 1998. Meanwhile, the average premium rose nationally from $551.95 in 1989 to $704.32 in 1998. California's rank dropped from the third costliest state to the 20th.

As of 2001, the situation was even better. The average annual premium in California was $688.89 (Rank 23) vs. $717.70 for the nation. So, from the time California went from reliance simply on competition as insurers envisioned it to full competition and regulation, the average auto rate fell by 7.9 percent while the national average rose by 30.0 percent. A powerhouse result for consumers![4]

[3] "Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation," June 6, 2000; www.consumerfed.org.).

[4] State Average Expenditures & Premiums for Personal Automobile Insurance in 2001, NAIC, July 2003.

SOUTH CAROLINA AUTO INSURANCE DEREGULATION: HAVE CONSUMERS REALLY BENEFITED SIGNIFICANTLY?

The insurance industry points to the South Carolina Auto Insurance law change that took place in 1999 and claims that it is working well. This report will test this claim.

> "[NAIC] Director Csiszar's home state of South Carolina is a prime example of the benefits of free market reforms. By 1996, South Carolina's price control system had resulted in only 78 companies offering policies in the state and over 40 percent of insured drivers being placed in the assigned risk pool. Since the state adopted a flex-rating system backed by Director Csiszar in 1999, 105 new insurers have entered the market, average auto insurance rates have decreased, and the state's residual market plan insures less than 600 drivers, compared to more than 750,000 less than a decade ago. The end result of this modest reform is that the system is more fair and flexible, less political, and meets the needs of consumers."
>
> Press Release dated 2/4/04
> Property Casualty Insurers Association of America

CLAIM: AUTO INSURANCE RATES HAVE DECREASED

A. The "new" South Carolina system has caused higher rates for many consumers.

What insurers claim was a "dysfunctional" system was in fact a system that prevented insurers from redlining -- charging low income and minority consumers more because of where they lived. Under the Csiszar regime, insurers have had carte blanche to redline. In addition to the deregulation of rates, Csiszar adopted a regulation allowing insurers to use consumer credit information with no meaningful consumer protections. Csiszar allows insurers to charge higher rates to consumers simply because they buy the minimum limits of liability required by law. Why should a consumer be charged more just because he or she complied with the law? The numbers cited for average rates and rate changes mask the impacts on particular groups of consumers. While some consumers have fared okay under the let-insurers-do-whatever-they-want approach, many consumers have been hit with big rate increases. And the claims about lots of new insurers are equally hollow -- the "new" companies are simply the high-cost ("nonstandard") affiliates of insurers already operating in South Carolina. The numbers put forth by Csiszar's department are designed to hide the reality of the South Carolina market -- 21st century redlining as a "competitive market." What we don't see is market data to test the claims of success, data such as which companies are actually providing coverage in what zip codes and how rates have changed by zip code. We don't see the credit scoring models used by insurers that penalize consumers for being poor. We don't see the underwriting guidelines -- like prior liability limits -- that further penalize consumers for not being affluent.

B. Even the overall rate level has risen since the law was passed.

According to data published by the National Association of Insurance Commissioners, the average per car expenditure on insurance in South Carolina, the nation and California was:

Year	S.C.	USA	CA
1998	766	801	821
2001	744	817	795
Change			
'98 to '01	-2.9%	+2.0%	-3.2%

There is some question about whether the South Carolina data are accurate, having to do with a technical issue.[5] But even if these data are accurate, it is clear that the average expenditure in South Carolina is up in every year except from 1998 to 1999. From 1998 to 1999, South Carolina's average expenditure did drop by 8.2%. Interestingly, the national average also dropped that year, by 2.4%.

Rates in South Carolina did not drop by as much from 1998 to 2001 as those in California. California average expenditures have dropped by 3.2% from 1998 to 2001, while South Carolina's expenditures dropped 2.9% in that time.

Consumer groups point to California's regulatory system as the best in the nation. It relies on a very rigorous prior approval system of rates. As the Consumer Federation of America's in-depth study of regulation by the states revealed,[6] California's regulatory transformation has produced remarkable results. California's auto insurance rates dropped from the third costliest state in 1989 to the 23rd costliest in 2001.[7] From the time California went from reliance simply on competition as insurers envisioned it to full competition and regulation, the average auto rate fell by 7.9%, while the national average rose by 30.0%.

So, even taking the most optimal period for South Carolina (and ignoring the possible data problem), the result is not as good as California's result.

Automobile insurance reform in Hawaii provides another example of insurance reform that helps the state's consumers, resulting in dramatic decreases in the cost of insurance. During the same 1998 to 2001 time period, Hawaii's relative insurance cost went from the 11th highest in the nation to the 21st highest with premium reductions of 11.6%. Substantial parts of these decreases were the result of a strengthening of the state's prior approval law[8].

From 1997 (the year reform was passed in Hawaii) to 2001, the premiums dropped by an even more substantial 22.7%, moving the state from the 4th highest to the 21st highest rates in the nation. Again, substantial portions of these reductions were a direct result of the strengthening of the Commissioner's authority in approving rates.

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[5] There is question if the full recoupment charges, monies collected to fund the reinsurance facility, are in the data reported to the NAIC.

[6] "Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation," June 6, 2000; www.consumerfed.org.).

[7] State Average Expenditures & Premiums for Personal Automobile Insurance in 2001, NAIC, July 2003.

[8] Ibid.

In addition to these dramatic reductions in the cost of insurance, competition among insurance carriers in Hawaii increased (evidenced by a dramatic increase in automobile insurer advertising, reductions in consumer complaints regarding insurance availability, and other factors) and the number of uninsured motorists declined dramatically. The number of insured cars increased between year-end 1997 to year-end 2001 by more than 18% (far greater than any change in the state's population) providing convincing evidence that more and more previously uninsured drivers were buying insurance following passage of these reforms.

Experts in the South Carolina market advise CFA that auto earned premiums and associated rates have risen sharply in the state since 2001, the latest year in NAIC's analysis, and that South Carolina legislation provides virtually insurmountable obstacles for consumers to challenge the filings that bring about these automobile insurance premium increases.[9]

In South Carolina, the premiums grew by 30.2% from 1998 to 2002[10]. The population of South Carolina grew by 6.9% over that time.[11] The population adjusted premium increase in South Carolina was 21.8%. Similar calculations for the nation and California show a growth of 14.0% and 11.3% respectively.

It appears as though South Carolina Insurance Commissioner Csiszar agrees that increases are occurring. He has stated that "Since the law's adoption, the number of insurance companies writing auto insurance in the state has roughly doubled to about 160, while total premiums have gone from $1.65 billion to roughly $2 billion."[4] He is cited as referring to these increases as a "clear sign of success."[12]

CLAIM: CONSUMERS BENEFIT FROM THE JUMP IN NUMBER OF COMPANIES IN SOUTH CAROLINA

There has been a big jump in the number of insurance companies writing auto insurance in South Carolina, but that is largely due to the return to the market of high-priced so-called substandard insurance companies that are affiliates of insurers who were already in the market in South Carolina.

Under the previous law, good drivers were entitled to get insurance from the insurance company of their choice, an excellent protection for consumers. The 1999 law eliminated that protection. So, all of the high-priced running mates of established insurers came back into the state, since they now could force clients to buy policies from such insurers.

Here are some of the running mates that came back to South Carolina when this important consumer protection was eliminated:

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[9] "Kruger, the insurance department actuary, acknowledges that he adjusts down very few of the industry's roughly 3,000 rate requests each year. Rather than make frequent adjustments, he said, the department has established a policy that generally signs off on rate requests that are less than 25 percent. Requests above 25 percent undergo scrutiny and stand a good chance of being altered." Charleston Post and Courier, February 22, 2004.

[10] Report on Profitability by Line by State, 1998 and 2002 editions, NAIC

[11] U.S. Bureau of the Census.

[12] *Charleston Post and Courier*, 2/22/04.

1. Allstate

   Allstate Indemnity
   Deerbrook Ins. Co.

2. Nationwide

   Nationwide Mutual Fire Ins. Co.
   Nationwide Property & Casualty Ins. Co.

3. Horace Mann

   Allegiance Insurance Company
   Teachers Insurance Company

4. State Auto

   State Auto Fire Insurance Company
   State Auto P&C Insurance Company

5. GEICO

   GEICO Casualty Company
   GEICO General Insurance Company
   GEICO Indemnity Company

6. ORION Group

   Carolina American Insurance Company
   Guaranty National Insurance Company
   Peak P&C Casualty Insurance Corporation

7. Travelers Group

   Charter Oak Fire Insurance Company
   Phoenix Insurance Company
   Standard Fire Insurance Company
   Travelers Indemnity Company of America
   Travelers Indemnity Company of Illinois

8. State Farm

   State Farm Fire and Casualty Insurance Company

9. Seibels Group

   Catawba Insurance Company (now under administrative supervision in SC)
   South Carolina Insurance Company (now under administrative supervision in SC)

10. Liberty Group

Liberty Insurance Corporation
Liberty Mutual Fire Insurance Company

Consumers have been harmed by the influx of these high-priced insurers into South Carolina. What appears to be happening is that the established insurance companies that formerly offered policies at low prices are shifting people into their higher priced running mates. That is part of the reason that the initial drop in rates has given way to recent price spikes.

CONCLUSION

Commissioner Csiszar is now pushing to expand his auto insurance "successes" to homeowners and other property and casualty lines of insurance. According to Csiszar, the point of this new legislation is to completely remove the South Carolina Insurance Consumer Advocate's ability to challenge any rate increases at all[13]. The new legislation follows less than a year after the state's Consumer Advocate successfully challenged (among other things) a deal that had been cut between the Insurance Department and State Farm. The deal would have allowed for increases up to 524% for some coastal homeowners, and increases in excess of 300% in other areas of South Carolina[14].

Unlike South Carolina, California has not approved the use of credit scores or prior liability limits for rate setting purposes, thereby protecting the less affluent residents of the state.

At best, there has been modest improvement for a select few consumers in South Carolina, while others have been hurt. California's Proposition 103 system beats South Carolina's hands down and remains the system legislators should emulate.

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[13] *Charleston Post and Courier*, 2/22/04.
[14] Consumer Advocate expert's (Simons') testimony in State Farm case

Consumer Principles and Standards for Insurance Regulation

1. Consumers should have access to timely and meaningful information of the costs, terms, risks and benefits of insurance policies.

- Meaningful disclosure prior to sale tailored for particular policies and written at the education level of average consumer sufficient to educate and enable consumers to assess particular policy and its value should be required for all insurance; should be standardized by line to facilitate comparison shopping; should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); should address non-English speaking or ESL populations.
- Insurance departments should identify, based on inquiries and market conduct exams, populations that may need directed education efforts, e.g., seniors, low-income, low education.
- Disclosure should be made appropriate for medium in which product is sold, e.g., in person, by telephone, on-line.
- Loss ratios should be disclosed in such a way that consumers can compare them for similar policies in the market, e.g., a scale based on insurer filings developed by insurance regulators or independent third party.
- Non-term life insurance policies, e.g., those that build cash values, should include rate of return disclosure. This would provide consumers with a tool, analogous to the APR required in loan contracts, with which they could compare competing cash value policies. It would also help them in deciding whether to buy cash value policies.
- Free look period with meaningful state guidelines to assess appropriateness of policy and value based on standards the state creates from data for similar policies.
- Comparative data on insurers' complaint records, length of time to settle claims by size of claim, solvency information, and coverage ratings (e.g., policies should be ranked based on actuarial value so a consumer knows if comparing apples to apples) should be available to the public.
- Significant changes at renewal must be clearly presented as warnings to consumers, e.g., changes in deductibles for wind loss.
- Information on claims policy and filing process should be readily available to all consumers and included in policy information.
- Sellers should determine and consumers should be informed of whether insurance coverage replaces or supplements already existing coverage to protect against over-insuring, e.g., life and credit.
- Consumer Bill of Rights, tailored for each line, should accompany every policy.
- Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurer should give consumer notice of feedback procedure at end of transaction, e.g., form on-line or toll-free telephone number.

2. Insurance policies should be designed to promote competition, facilitate comparison-shopping and provide meaningful and needed protection against loss.

- Disclosure requirements above apply here as well and should be included in design of policy and in the policy form approval process.
- Policies must be transparent and standardized so that true price competition can prevail. Components of the insurance policy must be clear to the consumer, e.g., the actual current and future cost, including commissions and penalties.
- Suitability or appropriateness rules should be in place and strictly enforced, particularly for investment/cash value policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.

- "Junk" policies, including those that do not meet a minimum loss ratio, should be identified and prohibited. Low-value policies should be clearly identified and subject to a set of strictly enforced standards that ensure minimum value for consumers.
- Where policies are subject to reverse competition, special protections are needed against tie-ins, overpricing, e.g., action to limit credit insurance rates.

3. All consumers should have access to adequate coverage and not be subject to unfair discrimination.

- Where coverage is mandated by the state or required as part of another transaction/purchase by the private market, e.g., mortgage, regulatory intervention is appropriate to assure reasonable affordability and guarantee availability.
- Market reforms in the area of health insurance should include guaranteed issue and community rating and where needed, subsidies to assure health care is affordable for all.
- Information sufficient to allow public determination of unfair discrimination must be available. Zip code data, rating classifications and underwriting guidelines, for example, should be reported to regulatory authority for review and made public.
- Regulatory entities should conduct ongoing, aggressive market conduct reviews to assess whether unfair discrimination is present and to punish and remedy it if found, e.g., redlining reviews (analysis of market shares by census tracts or zip codes, analysis of questionable rating criteria such as credit rating), reviews of pricing methods, reviews of all forms of underwriting instructions, including oral instructions to producers.
- Insurance companies should be required to invest in communities and market and sell policies to prevent or remedy availability problems in communities.
- Clear anti-discrimination standards must be enforced so that underwriting and pricing are not unfairly discriminatory. Prohibited criteria should include race, national origin, gender, marital status, sexual preference, income, language, religion, credit history, domestic violence, and, as feasible, age and disabilities. Underwriting and rating classes should be demonstrably related to risk and backed by a public, credible statistical analysis that proves the risk-related result.

4. All consumers should reap the benefits of technological changes in the marketplace that decrease prices and promote efficiency and convenience.

- Rules should be in place to protect against redlining and other forms of unfair discrimination via certain technologies, e.g., if companies only offer better rates, etc. online.
- Regulators should take steps to certify that online sellers of insurance are genuine, licensed entities and tailor consumer protection, UTPA, etc. to the technology to ensure consumers are protected to the same degree regardless of how and where they purchase policies.
- Regulators should develop rules/principles for e-commerce (or use those developed for other financial firms if appropriate and applicable)
- In order to keep pace with changes and determine whether any specific regulatory action is needed, regulators should assess whether and to what extent technological changes are decreasing costs and what, if any, harm or benefits accrue to consumers.
- A regulatory entity, on its own or through delegation to independent third party, should become the portal through which consumers go to find acceptable sites on the web. The standards for linking to acceptable insurer sites via the entity and the records of the insurers should be public; the sites should be verified/reviewed frequently and the data from the reviews also made public.

5. Consumers should have control over whether their personal information is shared with affiliates or third parties.

- Personal financial information should not be disclosed for other than the purpose for which it is given unless the consumer provides prior written or other form of verifiable consent.
- Consumers should have access to the information held by the insurance company to make sure it is timely, accurate and complete. They should be periodically notified how they can obtain such information and how to correct errors.
- Consumers should not be denied policies or services because they refuse to share information (unless information needed to complete transaction).
- Consumers should have meaningful and timely notice of the company's privacy policy and their rights and how the company plans to use, collect and or disclose information about the consumer.
- Insurance companies should have clear set of standards for maintaining security of information and have methods to ensure compliance.
- Health information is particularly sensitive and, in addition to a strong opt-in, requires particularly tight control and use only by persons who need to see the information for the purpose for which the consumer has agreed to sharing of the data.
- Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

6. Consumers should have access to a meaningful redress mechanism when they suffer losses from fraud, deceptive practices or other violations; wrongdoers should be held accountable directly to consumers.

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. UTPAs should provide private cause of action.
- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.
- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be independent, fair and neutral decision-maker.
- Private attorney general provisions should be included in insurance laws.
- There should be an independent agency that has as its mission to investigate and enforce deceptive and fraudulent practices by insurers, e.g., the reauthorization of FTC.

7. Consumers should enjoy a regulatory structure that is accountable to the public, promotes competition, remedies market failures and abusive practices, preserves the financial soundness of the industry and protects policyholders' funds, and is responsive to the needs of consumers.

- Insurance regulators must have clear mission statement that includes as a primary goal the protection of consumers:
- The mission statement must declare basic fundamentals by line of insurance (such as whether the state relies on rate regulation or competition for pricing). Whichever approach is used, the statement must explain how it is accomplished. For instance, if competition is used, the state must post the review of competition (e.g., market shares, concentration by zone, etc.) to show that the market for the line is workably competitive, apply anti-trust laws, allow groups to form for the sole purpose of buying insurance, allow rebates so agents will compete, assure that price information is available

from an independent source, etc. If regulation is used, the process must be described, including access to proposed rates and other proposals for the public, intervention opportunities, etc.

- Consumer bills of rights should be crafted for each line of insurance and consumers should have easily accessible information about their rights.
- Insurance departments should support strong patient bill of rights.
- Focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within regulatory body should be established for education and outreach to consumers, including providing:
- Interactive websites to collect from and disseminate information to consumers, including information about complaints, complaint ratios and consumer rights with regard to policies and claims.
- Access to information sources should be user friendly.
- Counseling services to assist consumers, e.g., with health insurance purchases, claims, etc. where needed should be established.
- Consumers should have access to a national, publicly available database on complaints against companies/sellers, i.e., the NAIC database.
- To promote efficiency, centralized electronic filing and use of centralized filing data for information on rates for organizations making rate information available to consumers, e.g., help develop the information brokering business.
- Regulatory system should be subject to sunshine laws that require all regulatory actions to take place in public unless clearly warranted and specified criteria apply. Any insurer claim of trade secret status of data supplied to regulatory entity must be subject to judicial review with burden of proof on insurer.
- Strong conflict of interest, code of ethics and anti-revolving door statutes are essential to protect the public.
- Election of insurance commissioners must be accompanied by a prohibition against industry financial support in such elections.
- Adequate and enforceable standards for training and education of sellers should be in place.
- The regulatory role should in no way, directly or indirectly, be delegated to the industry or its organizations.
- The guaranty fund system should be prefunded, national fund that protects policyholders against loss due to insolvency. It is recognized that a phase-in program is essential to implement this recommendation.
- Solvency regulation/investment rules should promote a safe and sound insurance system and protect policyholder funds, e.g., rapid response to insolvency to protect against loss of assets/value.
- Laws and regulations should be up to date with and applicable to e-commerce.
- Antitrust laws should apply to the industry.
- A priority for insurance regulators should be to coordinate with other financial regulators to ensure consumer protection laws are in place and adequately enforced regardless of corporate structure or ownership of insurance entity. Insurance regulators should err on side of providing consumer protection even if regulatory jurisdiction is at issue. This should be stated mission/goal of recent changes brought about by GLB law.
- Obtain information/complaints about insurance sellers from other agencies and include in databases.
- A national system of "Consumer Alerts" should be established by the regulators, e.g., companies directed to inform consumers of significant trends of abuse such as race-based rates or life insurance churning.
- Market conduct exams should have standards that ensure compliance with consumer protection laws and be responsive to consumer complaints; exam standards should include agent licensing, training and sales/replacement activity; companies should be held responsible for training agents and monitoring agents with ultimate review/authority with regulator. Market conduct standards should be part of an accreditation process.

- The regulatory structure must ensure accountability to the public it serves. For example, if consumers in state X have been harmed by an entity that is regulated by state Y, consumers would not be able to hold their regulators/legislators accountable to their needs and interests. To help ensure accountability, a national consumer advocate office with the ability to represent consumers before each insurance department is needed when national approaches to insurance regulation or "one-stop" approval processes are implemented.
- Insurance regulator should have standards in place to ensure mergers and acquisitions by insurance companies of other insurers or financial firms, or changes in status of insurance companies (e.g., demutualization, non-profit to for-profit), meet the needs of consumers and communities.
- Penalties for violations must be updated to ensure they serve as incentives against violating consumer protections and should be indexed to inflation.

8. Consumers should be adequately represented in the regulatory process.

- Consumers should have representation before regulatory entities that is independent, external to regulatory structure and should be empowered to represent consumers before any administrative or legislative bodies. To the extent that there is national treatment of companies or "one-stop" (OS) approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the OS state or any other approving entity.
- Insurance departments should support public counsel or other external, independent consumer representation mechanisms before legislative, regulatory and NAIC bodies.
- Regulatory entities should have well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., consumer advisory committee. This is particularly true to ensure needs of certain populations in state and needs of changing technology are met.

TESTIMONY OF PHILIP R. O'CONNOR, Ph.D.
TO THE UNITED STATES HOUSE COMMITTEE
ON FINANCIAL SERVICES
MARCH 31, 2004

Thank you Mr. Chairman and Members of the Committee for your invitation to appear today. My name is Philip R. O'Connor and I served from 1979 to 1982 as Illinois Director of Insurance and prior to that as deputy director for research and urban affairs. For three years I served as Chairman of the Illinois Commerce Commission, our state's utility regulatory agency. Since 1986 have been in private consulting as well as in the energy business in which I am currently engaged. I have attached a brief resume to my testimony.

I testified previously on June 21, 2001to Mr. Baker's Subcommittee on Capital Markets, Insurance and Government Sponsored Entities during the earlier stages of your oversight inquiries into insurance regulation.

60 Years since the Southeastern Underwriters Decision

In just two months, we will be commemorating the sixtieth anniversaries of the momentous events of the first week of June 1944. Allied Forces liberated Rome and carried out the long awaited D-Day landings on the coast of France. In that same week there was a far less noticed event but one that has also had long lasting significance. In the 1944 *Southeastern Underwriters* case, the United States Supreme Court determined that insurance was indeed interstate commerce and subject to Congressional regulation under the Constitution's "commerce clause." Insurance was, therefore, subject to the antitrust laws.

After that decision, Congress promptly delegated the job of insurance regulation to the states and granted a rather expansive exemption from much of the Federal anti-trust laws to the extent that a state regulated aspects of insurance. We should be clear. There is no issue of states' rights here since the Supreme Court dispensed with that question 60 years ago. It is, rather, a question of how can we do the best job for consumers in assuring the availability, integrity and solidity of the insurance promise.

A great deal has changed in the larger world as well as in the world of insurance and insurance regulation in the past sixty years. This Committee is right on target in reviewing how the states are handling this important delegation of authority and whether Congress should take on a greater role in setting standards for the regulation of insurance.

The Committee has identified two central themes for today's hearing, whether competitive insurance markets better serve consumers and whether certain state based reforms can effectively promote nationwide standards in regulation. I will be suggesting that the evidence is clear that competitive insurance markets are far superior for consumers and as for rate regulation, it is time to consider at the national level active promotion of the Illinois Model that relies on antitrust principle in insurance pricing.

30 Years of Progress in State Regulation....But There Are also Shortfalls

Over the past three decades, the states have dramatically improved the quality of regulation in a number of areas. In cooperation with one another

through the National Association of Insurance Commissioners (NAIC), the states have made considerable progress in achieving substantial professional conformity and harmonization of standards and performance in such areas as financial and solvency oversight, investment regulation and operation of guaranty funds to protect consumers in the event of liquidations. I am pleased to note that Illinois has been an innovator and a leader in these areas of reform.

Not as successful, however, have been efforts to better harmonize the process for policy forms oversight and product innovation, underwriting regulation, allowing for more efficient distribution and marketing and applying consistent standards and efficient methods in market conduct examinations. In the important arena of rate setting, about half the states continue to put their faith in outmoded prior approval rate regulation regimes. Prior approval methods have remained largely unchanged since World War II when Congress delegated regulatory power to the states.

Quite sensibly, the Committee is paying attention to the areas in which there remains significant disparity among the states. And the relevant question is whether these disparities are warranted in the regulation of an industry that must be considered today to be far more "interstate commerce" than ever before.

Insurance Rate Regulation since McCarran-Ferguson

In its delegation of insurance regulatory authority to the states with the passage of the McCarran-Ferguson Act in 1945[1], Congress was engaged in accommodating much of the *status quo ante* and the applicability of the antitrust laws. There was a common expectation that the states would exercise control over rates, in great part for the traditional purpose of setting rates that would be designed to maintain levels sufficient to minimize the risk of insolvency due to inadequate pricing. By 1947, most states responded by enacting rating laws based on a model NAIC law that licensed industry data organizations (rating bureaus) but made sure to insert the state as the entity that approved rates and assured their use. Previously, the rating bureaus in many states had enforced rate adherence.

By the mid-1960s, a number of states had taken the path blazed by California in 1947 or relying on competitive pricing rather than prior approval. These states were trying to address a serious shortage in the auto insurance markets that were being exacerbated by increasingly adverse prior approval rate decisions. The Illinois experiment of reliance on antitrust principles emerged from that era. Eventually, in 1981, the NAIC adopted an alternative competitive rating law for consideration by the states.

Heading into the decade of the 90s, California voters, in reaction to a tort driven run-up in auto insurance rates, adopted Proposition 103 that instituted prior approval to replace its trailblazing 1947 competitive rating law. While Prop 103 was dramatic and has been portrayed as somehow revolutionary, court decisions and regulations promulgated since passage have made the

[1] U.S. Code Section 101 et seq. (1945)

California system a fairly traditional prior approval system with a bias toward reliance on competitive forces.[2]

Today, rate regulatory regimes run the gamut. There are rates that are basically "state made", prior approval of rates with extensive proceedings, prior approval with light handed oversight, "flex-rating" systems that review rate changes exceeding certain thresholds, competitive pricing with residual review mechanisms and the Illinois Model. In all cases, insurers are able to participate to one extent or another in loss data collection and analysis by state-licensed organizations.

Competitive Rating is Superior to Prior Approval Regulation

It is rate regulation that we find some of the deepest disagreements about regulatory policy. In my opinion, however, the experience and the research of the past thirty years actually leave little room for substantive disagreement. In my view, the verdict is in. Classic prior approval rate regulation offers no protection for consumers. If anything, it perpetuates a costly illusion that government price regulation can magically lower prices below competitive market levels while at the same time stimulating an adequate supply of coverage for a growing economy and the protection of business and family assets.

[2] In my June 21, 2001 written testimony to the Subcommittee I devoted considerable space to a review of the report of the Consumer Federation of America authored by Robert Hunter contending that Proposition 103 represented a significantly new and different approach to rate regulation and had produced substantial beneficial results. I concluded that in the end the system produced by Prop 103 was neither all that new and different nor has it produced significant benefits. The available independent academic research largely coincides with my conclusions. See "Regulation of Automobile Insurance in California" in *Deregulating Property-Liability Insurance: Restoring Competition and Increasing Market Efficiency*, J. David Cummins (Editor), Brookings-AEI Joint Center, May 2002.

I believe that, for the most part, those states that stay with prior approval systems do so largely out of habit and inertia. It is no longer seriously contended that state rate regulation provides any particular assistance to solvency oversight, an original objective of rate regulation. Over the past 60 years there have been substantial advances in state financial regulation and in actuarial techniques and massive expansion of loss data bases. Some states, however, have found themselves in such deep trouble with the results of historically over-regulating their markets that they now have genuine difficulty making the hard decisions to take a new course. Finally, a few have made decisions to revert to prior approval in some form.

Virtually every bit of reputable academic and governmental research conducted over the past thirty years either concludes that reliance on competitive pricing in insurance produces appreciable tangible consumer benefits or, at the very least, prior approval produces no discernible benefits for consumers. The minimal support for price regulation in the literature is to be found mainly in polemical papers from one advocacy organization or another. The essence of the story is that we have a level of consensus rare in the social sciences and studies of government policy.

In 2001 my testimony included a summary of a report I had co-authored for delivery to the National Conference of Insurance Legislators (NCOIL).[3] There were some basic conclusions in that report that go directly to the heart of the Committee's theme of whether consumers are better served by

[3] *Modernizing Insurance Rate Regulation: Tacking to the Winds of Change*, by Philip R. O'Connor, Ph.D. and Eugene P. Esposito, J.D., PROactive Strategies, Inc., April 2001. (Available on request from Phil_OConnor@earthlink.net)

competitive markets. There is a strong basis for believing that those conclusions remain unaltered today.

- Prior approval states show no evidence of being able to keep rates lower than in competitive states;
- Among the dozen most costly auto insurance states, prior approval rate regulation is the pre-dominant regime[4];
- Prior approval states tend to have higher exit and lower entry rates of insurance companies, with some states such as Massachusetts and New Jersey having lost over half of the auto insurance companies operating in those states between 1980 and 1999 and others losing about one-third of their homeowners insurers (see charts attached to this testimony);
- Prior approval states tend to have auto insurance residual markets (provider of last resort pools) with larger market shares than do competitive states (see the charts attached to my testimony);
- Prior approval states tend to have more volatile loss ratios than do competitive states, suggesting larger and more erratic price swings;
- Prior approval states do not, as a group, have long-run average loss ratios much different than do competitive states, indicating that consumers do not get more of their insurance dollar back in claims payments;
- Prior approval states tend to create large cross-subsidies within the voluntary market as a result of more intervention in risk classification;

[4] See the Facts and Statistics section of the Insurance Information Institute's website for the most recent state comparison of auto insurance rates at http://www.iii.org/media/facts/statsbyissue/auto/

- Prior approval states tend to have larger subsidy flows to the residual markets;
- Consumers receive less accurate and less timely price signals about risk whereas in prior approval states consumers are more likely to see market conditions manifested in shortages of coverage;
- Prior approval states allocate regulatory resources to an unproductive regulatory ritual;
- In prior approval states, price changes tend to be political events rather than normal economic events.

The Illinois Model: Reliance on Antitrust Principles in Pricing

My own research work, beginning when I was research director at the Illinois Insurance Department in the late 1970s, has been oriented toward comparative studies of the performance of different rate regulatory regimes across the states and over time. As a result of my research and as a former insurance regulator in Illinois, I have become increasingly convinced that what has often been called the Illinois experiment has evolved into a proven model that Congress and other states should carefully consider for widespread adoption.

Since 1971, Illinois has operated without a law regulating property and casualty insurance rate, with the exception of workers compensation and medical malpractice. In those two lines, the law provides that rates in a competitive market are deemed not to be excessive and there is residual authority for the Director if the market is found non-competitive. Illinois

was the first state to implement the conversion from classic prior approval in workers compensation in 1983.

The Illinois Model, in effect, accepts the applicability of Federal anti-trust laws to most property and casualty insurance pricing in the state. Certain important areas of common activity such as loss data collection and analysis can be conducted in concert under state oversight but pricing is an individual insurance company responsibility.

The Illinois Model is simple and requires minimal regulatory resources. It creates a climate that attracts the largest share of operating P&C companies (see the charts attached to my testimony) of any state in the nation and has been the key reason that periods of inadequate supply in any line of coverage have tended to be short. Repeated surveys comparing homeowners and auto insurance rates across states consistently finds Illinois right in the middle.[5] One indicator of the success of the Illinois model is that political controversy about insurance rates has been fairly rare over the years, especially in contrast to a variety of prior approval states where the controversy never seems to end. Neither house of the Illinois General Assembly has ever passed a bill to impose rate regulation in any form since 1969.

Interestingly, the Illinois Model was not so much an experiment as it was a happy accident. In 1971, the General Assembly was unable to agree on re-enactment of or changes to a two-year trial run of a competitive rating law to replace the classic prior approval law. To the surprise of everyone, it seems,

[5] See the Facts and Statistics section of the Insurance Information Institute's website for the most recent state comparison of auto insurance rates at http://www.iii.org/media/facts/statsbyissue/auto/

the lack of a trigger re-imposing the old law left Illinois with no P&C rating law at all. At first, when the roof did not fall in, there was little motive to act. As the years went on, partly during the time I was Director, we all began to figure out that what we were originally embarrassed by, was actually becoming a badge of honor. The Illinois Model was the result of a "penicillin scenario."

The key specific elements of the Illinois Model are:

- Property-liability rates, other than for workers compensation and medical malpractice, are not subject to regulatory review or action by reason of excessiveness or inadequacy. Work comp and med mal rates are deemed not excessive as long as the Director has not made a finding of a noncompetitive market.
- Illinois law prohibits unfair discrimination. No rate can be charged to a consumer by reason of race, color, religion or national origin, nor can auto insurance applications be rejected solely by reason of physical handicap. The law provides for the Director of Insurance and the Attorney General to pursue other unfair competitive practices that the law has not specifically defined.
- For purposes of setting auto liability rates auto insurers may not subdivide a municipality (Chicago).

- The General Assembly has provided for specific, targeted discounts associated with such public policy objectives such as encouraging the installation of auto anti-theft devices and senior citizen driver training.
- Insurers are permitted to participate in the joint development of trended (forecasted) loss cost data for all lines, including workers compensation, through licensed advisory organizations.
- The Illinois Insurance Department requires insurers to individually file illustrative rates for auto and homeowners insurance and personal lines cancellation, non-renewal and new policy counts by ZIP Code in order to help in the monitoring of competitive developments.
- Residual market mechanisms (the auto assigned risk program, the FAIR plan for fire, homeowners and renters and workers comp assigned risk) are subject to prior approval rate regulation by the Director of Insurance. Rates are set with attention to avoiding under-pricing that would encourage excessive use of the plans. These plans in Illinois have small market shares: auto 0.03%, FAIR Plan 0.25% and work comp between 8 and 9% in the hard market of 2003).
- There are various limitations and disclosure requirements with respect to cancellations and non-renewals of auto and dwelling fire and homeowners policies, information about eligibility for the auto

assigned risk plan and FAIR Plan and how to contact the Insurance Department to file a complaint. Premium refund standards are set by law.

- Illinois continues to regulate rates in credit insurance, a line that is characterized by the potential of "reverse competition."
- The Illinois Insurance Department also conducts an annual, in-depth review of market conditions and the availability and affordability of personal and commercial property-liability insurance pursuant to Illinois Insurance Cost Containment Act of 1986.

Researchers have repeatedly compared Illinois to other states in terms of important outcomes and Illinois consistently fares well. Auto and homeowners insurance prices are always right in the middle of all states, residual market populations have been perennially low, over-the-phone price quotes are readily available in personal lines, the state has the largest number of licensed personal lines insurers and the Illinois Insurance Department has been able to devote resources to professionalizing its capabilities.

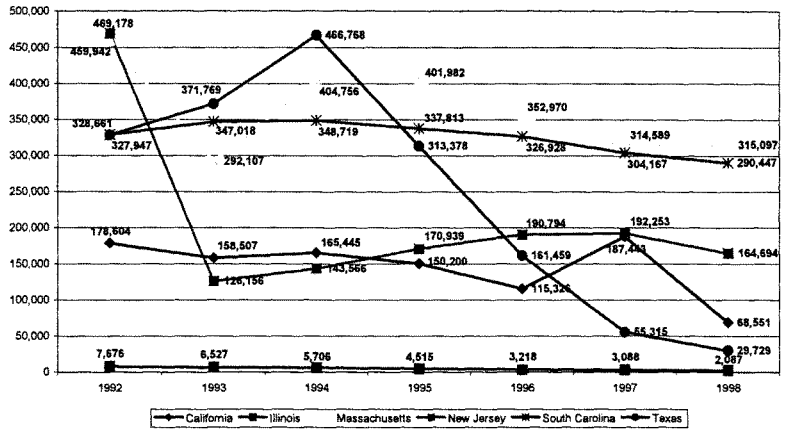
The Illinois Model Could Work Well across the Country

After more than thirty years of operation, the Illinois Model is ripe for export and possibly even for adoption at the national level. The Illinois Model is an approach to P&C insurance rates that could be easily and confidently applied to all states. The Illinois Model does not require the creation of a new bureaucracy or the development of any complicated rules or standards. Transaction and compliance costs for regulated companies and consumers do not increase and are likely to decrease. In contrast, of course, application of a prior approval approach to all states would create new bureaucracies, require voluminous new rules and increase compliance costs.

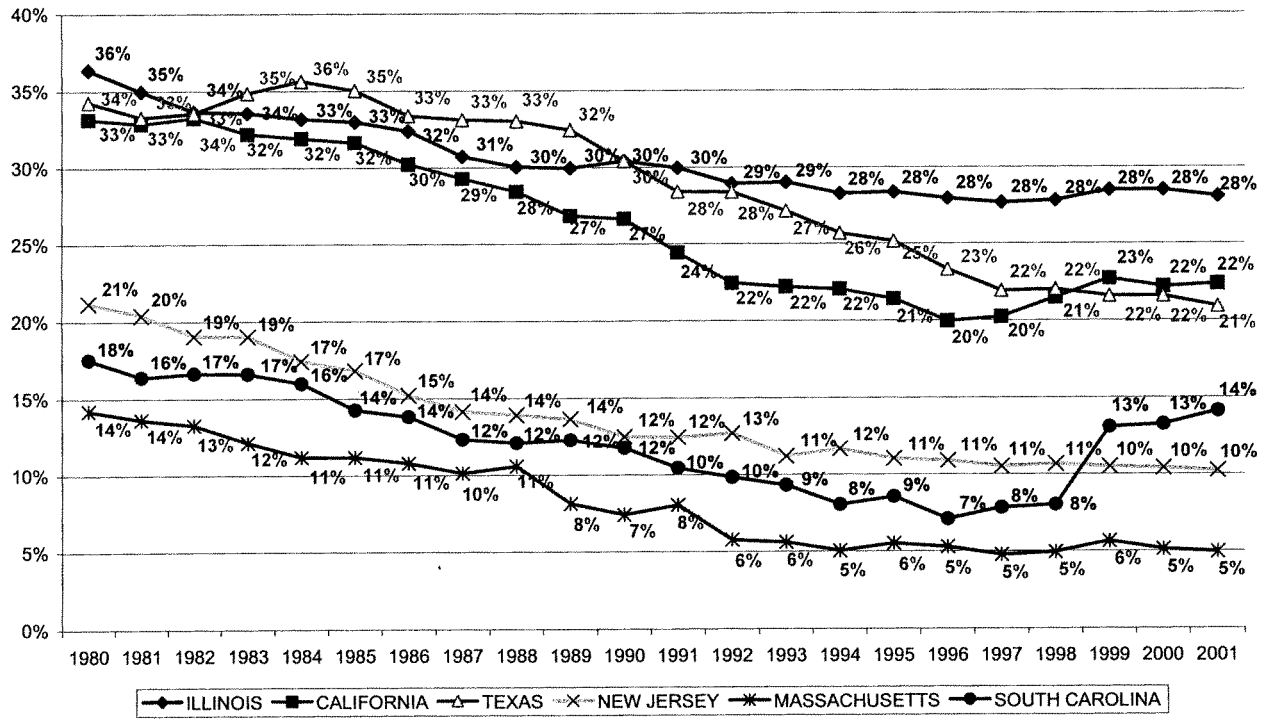
More important, however, the Illinois Model would be highly likely to deliver consumer benefits. Indeed, if every state were to address rate regulation by way of a reliance on competition and anti-trust principles, those states with competitive rating laws in operation would see little change, while those states with extreme prior approval systems that produce chronic shortages of insurers and insurance would see more normal markets develop. Consumers would have more options to meet their needs and insurers likely see a lower cost of capital, all things being equal, to the extent that regulatory risk in pricing was largely eliminated.

For Congress, the interesting question to consider is that while the Illinois Model has proven itself, not even Illinois adopted its approach consciously and directly. As explained, the Illinois Model was serendipitous. It may well be that for other states to take the steps necessary to install the Illinois Model, there will need to be serious encouragement to do so or perhaps even Federal legislation that would help states effectuate the change.

Residual Market Private Passenger Liability Premium 1992-98 (000 omitted)
[Source AIPSO Facts 1999]
Figure: 1



Private Passenger Automobile 1980-2001
Six State % of U.S. Companies Available To Sell Auto Insurance
[Source: A.M. Bset Executive Data Service]



HEARING ON "WORKING WITH STATE REGULATORS TO INCREASE INSURANCE CHOICES FOR CONSUMERS"
STATEMENT BY JANICE OCHENKOWSKI
OF THE RISK AND INSURANCE MANAGEMENT SOCIETY
BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

RICHARD BAKER, CHAIR

March 31, 2004

Good morning Mr. Chairman and Members of the Subcommittee. My name is Janice Ochenkowski. I am the Vice-President of External Affairs for the Risk and Insurance Management Society (RIMS), the largest professional organization for the risk management community. I am also the Senior Vice-President, Risk Management for Jones Lang LaSalle, a multi-national real estate company based in Chicago. I appreciate the opportunity to appear before you today on the issue of insurance choices for consumers.

RIMS is in a unique position to participate in this hearing, as we represent the commercial consumers of insurance. RIMS member companies, which number over 4,000, support the advancement of efficient insurance purchasing abilities. RIMS membership spans the country and consists of entities of all different industries and sizes, including 84 percent of the Fortune 500 companies, as well as approximately 950 "small businesses," those companies with less than 500 employees.

Nearly two years ago, RIMS spoke before this committee on the different insurance vehicles that are available to risk managers in their search to provide as much protection as possible for their company's assets. We made a case for immediate and significant reform of the state insurance system that has only grown stronger over the last

two years. RIMS also expressed its hope that one day an optional federal insurance charter would be made available for insurers operating in different states; an insurance vehicle that would free companies of the time and expense of securing individual contracts in each state of operation, with varied rates and forms. It is still RIMS belief that an optional federal charter will streamline insurance purchasing for consumers, and make the U.S. insurance system significantly more efficient.

However, the reality is that some view an optional federal insurance charter as too extreme a solution – an idea whose time has not yet come. Chairman Oxley and Subcommittee Chairman Baker's proposals to reform state regulation of insurance are reasonable and attainable, and will provide a much-needed opportunity for national uniformity and free market competition without excess regulation. RIMS fully supports the Oxley-Baker reform proposal, and urges Congress to enact these reforms as soon as possible.

In this increasingly competitive marketplace, commercial insurance consumers, like myself, need choices, flexibility, and speed. Operating throughout the country and the world as the primary insurance buyer for Jones Lang LaSalle, I am witness everyday to the numerous inefficiencies in the current state insurance system. Commercial consumers have struggled within a hobbled system long enough. These inefficiencies must be addressed and I applaud the members of this committee for presenting us with a meaningful blueprint for reform.

RIMS also recognizes the efforts of the NAIC in moving the U.S. insurance system fully into the 21st century. The NAIC has made real strides in personal lines insurance reform, but much more needs to be done for commercial consumers. The NAIC can only develop model laws; it cannot force state legislatures to adopt them. Even when states adopt NAIC models, inevitably changes are made which result in 50 different approaches to regulation of the industry. The Oxley-Baker proposal offers a chance to bring the best of state regulation and federal oversight together in a way that will preserve states' role, yet streamline and modernize the system for the benefit of consumers.

As this Congress and the NAIC move forward together to reform the U.S. insurance system, I would like to address some areas of concern for RIMS and the risk management community, including: market rates and forms; lead state concept for multi-state companies; and the Liability and Risk Retention Act.

Several years ago, there was momentum at the NAIC to adopt a model law and regulation with respect to commercial lines rate and form deregulation. The NAIC adopted one short version of commercial lines deregulation; however, a more comprehensive version has not been adopted. The National Conference of Insurance Legislators has also adopted a model commercial lines deregulation act. The problem with these model acts is that the states alter them, sometimes significantly, when adopted. For example, the premium threshold for commercial rates and forms to be deregulated ranges from $10,000 to $500,000, depending on a particular state's law. A few states

have no requirements at all for filing rates and forms for commercial lines of insurance. RIMS supports the Oxley-Baker principle that a uniform standard be adopted that provides for free market competition of rates and forms for commercial lines of insurance.

Our experience is that in a free, open, and competitive market, risk managers will be able to negotiate the best rates and the best terms and conditions for coverages needed by our companies. RIMS believes that a national standard of freedom from form and rate regulation should encompass surplus lines policies as well. Currently, surplus lines policies' rates and forms are not regulated by the states; however, we think it would be prudent to include freedom from rate and form regulation for surplus lines policies in any federal statute governing commercial property and casualty insurance. Therefore, RIMS suggests that legislation should include a provision that no state, territory, or the District of Columbia shall regulate or control in any manner whatsoever the rates or the terms and conditions of commercial lines insurance policies. My home state of Illinois is a model for the commercial lines modernization that we are suggesting. In Illinois, the insurance market is strong and competitive, and insurance is widely available for consumers.

Some states have requirements that before an insurance buyer can obtain insurance from the surplus lines market, a diligent search of authorized insurers must be made to determine if the insurance is available through an authorized insurer. Commercial consumers should be allowed access to the surplus lines market without having to make this type of determination. At least eight states have enacted provisions

in their commercial lines insurance deregulation laws permitting certain commercial buyers automatic access through a licensed surplus lines broker to the surplus lines market as well as to the admitted market. The NCOIL Property/Casualty Insurance Modernization Act permits the automatic export concept allowing certain commercial buyers to have automatic access through a licensed surplus lines broker to the surplus lines market, as well as to the admitted market. Thus, RIMS recommends that legislation permit commercial consumers to purchase insurance from any eligible unauthorized insurer without making a diligent search of authorized insurers as required by state law.

Most of RIMS' member companies are entities, like Jones Lang LaSalle, that do business throughout the United States and, in many cases, other parts of the world. In placing insurance, we as risk managers have to consider all of our exposures, no matter where they are located. When we purchase insurance, however, we are subject to individual state requirements with respect to our exposures in individual states. For example, there are many states that require that the licensed insurance producer who sells insurance to a company must be licensed in their individual state even though the risk in that state is an incidental exposure, such as a car on a fleet policy. Some states also require that special forms be added to policies, and in several cases, even require special color-coded paper. These requirements are burdensome, costly, and add no benefit to the commercial consumer; they are outdated and are simply not needed in today's commercial insurance marketplace. RIMS supports the Oxley-Baker concept of a leading state regulator for commercial policies covering multi-state exposures. Under this

concept, the state of the company's principal place of business would govern the insurance transaction, including the terms and conditions of the policy and the requirements that the producer be licensed.

This concept was discussed by the NAIC Producer Licensing Working Group in the development of the Producer Licensing Model Act (PLMA). Section 4(B)(6) of the PLMA exempts from producer licensing requirements "a person who is not a resident of this state who sells, solicits, or negotiates a contract of insurance for commercial property and casualty risks to an insured with risks located in more than one state insured under that contract provided that the person is otherwise licensed as an insurance producer to sell, solicit, or negotiate that insurance in the state where the insured maintains its principal place of business and the contract of insurance insures risk located in that state." This concept could be adopted as a uniform national standard, so that insurance producers would not have to be licensed in every state where a national company has a risk exposure. Similarly, a uniform provision which states that the law of the state in which the insured company has its principal place of business and insures risk in that state is the state that has jurisdiction over the commercial property and casualty insurance contract.

The federal Liability and Risk Retention Act (Risk Retention Act) is an excellent example of how the lead state concept can work. RIMS strongly supports the Risk Retention Act and, in fact, supports expanding its provisions to include the ability to insure property. Risk managers have found that having a variety of ways to protect their companies from risks is beneficial. The Risk Retention Act, which was first adopted in

1980 and then amended in 1986, has worked well in its 20-plus years of existence. Compared to the regular admitted insurance market, risk retention groups have performed well and have provided opportunities for companies to obtain coverages in areas where we have been unable to obtain coverages or where such coverages have been unaffordable.

Recently, there has been some criticism of the Risk Retention Act from regulators. Mostly, I believe they are unhappy because every state doesn't extensively regulate risk retention groups the way they regulate admitted companies. I suggest that individual state regulation of each admitted company is why there has been pressure for one-stop federal regulation. The Risk Retention Act provides significant safeguards for the chartering state and states in which risk retention groups operate.

Under federal law, risk retention groups must be chartered in a state. The chartering state regulates the formation and operation of the risk retention group. It must approve the plan of operation and feasibility study, which includes coverages, coverage limits, rates, and rating classification for each line of insurance the risk retention group plans to offer.

Any state, however, may require a risk retention group to:

1. Comply with unfair claims settlement practices laws;
2. Pay all applicable premium taxes;

3. Participate in any mechanism established or authorized under state law for equitable apportionment among insurers of liability insurance losses and expenses incurred on policies written through such mechanisms;
4. Register with and designate the state insurance commissioner as its agent for service of process;
5. Submit to a financial examination if (a) the commissioner of the domiciliary state has not begun one or (b) has refused to initiate an examination of the group; and
6. Comply with state false and deceptive practices laws.

In addition, a risk retention group must provide a copy of its plan of operation or feasibility study to any state in which the risk retention group does business. It must also provide a certified copy of the group's annual financial statement to the chartering state and to every state in which it is doing business.

RIMS believes that this balance of regulation between the chartering state and other states in which a risk retention group does business gives the chartering state control over the operation of the risk retention group and provides states in which the risk retention group is doing business sufficient information about the group to insure its solvency if it has any questions about the regulatory oversight of the chartering state. To protect consumers, any state insurance commissioner may petition any federal district court for an injunction if the commissioner believes the risk retention group is operating

in a hazardous financial condition. The injunction granted by the district court has nationwide effect.

Finally, I would like to address the issue of a federal enforcement mechanism to ensure state compliance with the proposed federal standards. The Oxley-Baker proposal calls for a federal coordinator, with little or no real influence, to work with the proposed federal-state advisory council. RIMS supports the concept of a federal coordinator, but believes that for national uniformity to work, this individual should have some authority to determine that state laws comply with federal uniform standards. Obviously, this will be a sensitive area, yet one that must be addressed if these reforms are to be given a chance at producing national uniformity and free market competition without excess regulation.

RIMS looks forward to working with your committee and the Congress on these critical issues. Thank you for the opportunity to speak today. I appreciate your time, interest, and leadership, and I welcome any questions by the Subcommittee.

Janice Ochenkowski

Janice Ochenkowski is Senior Vice President – Risk Management for Jones Lang LaSalle Incorporated headquartered in Chicago, Illinois. Jones Lang LaSalle is a global real estate services company, with offices in 36 countries. Ms. Ochenkowski has been responsible for risk management at Jones Lang LaSalle and its predecessor companies since 1980.

Ms. Ochenkowski is an active member of the Risk and Insurance Management Society, having served in officer and board positions at the Chapter and Society level. She currently serves as VP – External Affairs for the Society, which includes legislative work and outreach to industry associations. In addition, she has been a member of Society Committees, chaired the real estate industry group meetings and presented at the Society's annual conference.

Ms. Ochenkowski is a member of AIG's Intellirisk Advisory Council. She has been an invited speaker to the National Conference of the Building Owners' and Manager's Association (BOMA) and has spoken at NCREIF meetings on the subject of risk management.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Hearing on "Working with State Regulators to Increase Insurance Choices for Consumers"
March 31, 2004

Statement of Roger M. Singer
Managing Director, Senior Vice President and General Counsel
OneBeacon Insurance Group

Mr. Chairman, Members of the Subcommittee, my name is Roger Singer and I am Managing Director, Senior Vice President and General Counsel of OneBeacon Insurance Group, a multi-line organization of affiliated property and casualty insurance companies headquartered in Boston, Massachusetts, and operating through a network of regional and branch offices. OneBeacon is licensed in all 50 states, and markets its insurance products through independent insurance agents and brokers, principally in the New England states, New York, and New Jersey. I want to thank the subcommittee for allowing me to present my views today on behalf of OneBeacon and our property and casualty insurance trade association, the American Insurance Association (AIA).

I have been general counsel to OneBeacon and its predecessors for the last fifteen years. Prior to joining OneBeacon, I served as commissioner of insurance for the Commonwealth of Massachusetts from 1987 to 1989. Prior to my being insurance commissioner, I served in other capacities in Massachusetts state government as well as in the federal government at the Federal Trade Commission. I believe my background enables me to address the important issue before you today – national reform of the state insurance regulatory system – with my experience informed by being, at one time or another, on both sides of the insurance table: as an insurance regulator, and as an insurance company executive.

Because of OneBeacon's national scope and regional focus, we have familiarity with the full range of insurance regulatory systems employed and administered by the states and the District of Columbia. Fifty-one jurisdictions, operating independently of one another, have led to a patchwork-quilt regulatory system that creates inefficiency and is ultimately harmful to consumers. Even within each jurisdiction, there are often differing systems for different lines of business, making the process incredibly cumbersome and unresponsive to consumer needs. A limited survey by AIA of state requirements found approximately 350 that dictate how rates are to be filed and reviewed, and approximately 200 that relate to the filing and review of new products. National and regional companies often make thousands of filings each year. Last year, OneBeacon completed 454 filings in its eight "core" states alone. Add up the months and even years that it takes to review a company rate or form filing, and one does not have to be an actuary to calculate the cumulative inefficiency the state regulatory process imposes on the marketplace.

The National Association of Insurance Commissioner's (NAIC) efforts, while well-intentioned, can only go so far to produce uniformity and consistency of regulation. The NAIC can draft and adopt models, but cannot force state legislatures to enact them. Similarly, individual state insurance regulators can push for regulatory modernization in their own respective jurisdictions, but they cannot force other state insurance regulators to push for similar change. The history of post-McCarran Ferguson Act state insurance regulation demonstrates that structural change requires a federal push.

Sensing the urgent need and momentum for change, this subcommittee has called for systemic reform of rate, policy form, company licensing, and market conduct regulation, with a coordinated state-federal oversight role in each of these areas. And make no mistake about it, systemic reform is precisely what must occur for the good of insurance consumers and the health of the insurance marketplace.

Like other member companies of AIA, OneBeacon supports a market-based optional federal charter as the best way to achieve needed reforms with the least disruption to the state system. But, like AIA, we must be pragmatic about the pace of reform in the short term. Done correctly with appropriate reliance on market forces, targeted reform will: a) lead to national uniformity; b) reduce regulatory red tape; and c) enhance consumer protection by shifting regulatory attention and resources away from government price and product controls and toward ensuring financial stability so that insurance companies are able to pay claims when they arise.

In the area of insurance rates, the subcommittee's stated goal is to eliminate government price controls and to instead rely on Illinois-style, free-market competition. This is a significant step toward placing insurance on a level regulatory playing field with other non-monopolistic industries. In many ways, property and casualty insurance is the last outpost of the discredited economic theory of government price regulation. Government price controls do not work to the benefit of anyone – especially consumers. In states where rigid government price controls are prevalent, insurance premiums are higher and rates more politicized, consumer choices are restricted, residual markets are larger, and the number of competing insurers is lower.

The Massachusetts automobile insurance market provides a stark example of the unintended consequences of price controls. In Massachusetts, automobile insurance rates are set by the insurance commissioner, unless the commissioner determines (at an annual hearing) that sufficient competition exists to assure that rates will not be excessive. State-made rates are the worst form of government price controls, even worse than a strict prior approval system. The commissioner considers a number of factors when making this competitiveness determination, including whether a finding of competition will result in immediate rate increases. Inevitably, because of the political risk that a competitive market finding might trigger price increases, such a finding has never been made and rates continue to be set by the commissioner. This was the case when the very first decision was made under the statute in the 1970's, was the case when I was Massachusetts insurance commissioner during the late 1980's, and remains the case today. Unfortunately, my public sector and private sector experience has confirmed that the political consequences of moving directly to market-based rate regulation – the fear of short-term price spikes – often dooms any movement in that direction altogether.

Yet, there is plenty of evidence that elimination of Massachusetts' price control system for automobile insurance not only would result in lower premiums, but a healthier marketplace. When compared with Illinois, the one jurisdiction without any government price controls, Massachusetts falls well short – whether the comparison is measured by average automobile insurance premiums, number of drivers in the subsidized residual market, or number of competitors. The two state comparisons are not even close. Based on the latest available data from 2001:

- average annual automobile insurance premiums in Illinois were $748, compared with $1,013 in Massachusetts;
- 273 auto insurers actively competed for business in Illinois, compared with 38 automobile insurers competing in Massachusetts.
- 7.5% of Massachusetts drivers were in the residual market, compared with 0.02% of Illinois drivers;

In fact, one could argue that the percentage of drivers in the Massachusetts residual market is functionally closer to 25% because of Massachusetts' "exclusive representative producer" system – a system whereby over 25% of automobile insurance premium is produced by insurance brokers involuntarily appointed to insurers. In addition, the number of Massachusetts automobile insurers continues to shrink, as the latest numbers show only 20 carriers currently writing such insurance.

The differences between Illinois and Massachusetts are not surprising. Price controls can have the politically expedient short-term effect of holding insurance rates down. However, if left in place, those controls act as an artificial pressure cooker that hurts competition, masks systemic costs, leads to higher prices, and forces consumers into residual markets.

With respect to regulation of insurance policy forms, rather than a market-based system, the subcommittee has proposed a single point-of-filing with expedited review based on clear standards. This is a useful point of departure for examining alternative reform proposals. In jurisdictions with strict product controls, the government review process for product filings can take months or years from filing to approval, with product denial attached to unpublished, arbitrary "desk drawer" rules or regulations that have only tenuous connections to underlying statutory standards.

This process is especially frustrating for companies trying to roll out products regionally or nationally. The system provides no incentives for insurance product innovation. In turn, consumers have fewer different marketplace choices and no real basis to compare insurers by the products they offer. This process inhibits innovation and frustrates consumer choice.

Three principles should underlie the subcommittee's review of policy form -- or really more accurately, product -- regulation. First, if pre-market form regulation must remain in place as a general rule, the subcommittee should start with a market-friendly construct that will encourage insurance companies to innovate and provide consumers with a range

of policy options. An "informational filing" framework would provide such incentives. AIA and the Independent Insurance Agents and Brokers of America (IIABA) also have proposed federal preemption of state form approval laws more restrictive than "file and use" with a strict 30 calendar day review period based on specific statutory standards. Either one of these systems would represent a significant improvement over the current framework, provided that there was strong, enforceable preemption of anything more restrictive.

Second, as the subcommittee has suggested and the AIA-IIABA proposal envisions, government review of insurance policy forms must be based on clear standards. The best way to ensure that this principle is met is to look to specific state statutory law as the sole basis for review. States should not informally implement broad interpretations of state law to disapprove policy forms. Also, where a form is disapproved for broad "public policy" reasons, a national administrative process must be available to review the grounds for disapproval. National preemption cannot work without strong enforcement of the preemptive standard.

Third, commercial policy forms should not be subject to any state review or approval. All commercial policyholders, from small businesses to large conglomerates, deserve to be able to purchase insurance products tailored to their specific needs, and those products should be available without delay. Commercial policyholders and their insurers would benefit from the flexibility that market-based form regulation provides. That flexibility will spur innovation in commercial insurance products and allow policyholders to manage risk.

The subcommittee mentions limited review of policy forms for "sophisticated" commercial policyholders. We would urge the subcommittee to eliminate the distinction between so-called "sophisticated" and "unsophisticated" policyholders. The states' experience with statutory efforts to distinguish between "large" or "sophisticated" commercial policyholders and all others has largely been a failure, with states reaching radically different conclusions about the criteria and thresholds needed to define an exempt commercial policyholder. Looking only at the annual premium criteria for states enacting exempt commercial policyholder forms laws, the thresholds vary from a high of $250,000 to a low of $10,000. In the states with higher annual premium thresholds, only a fraction of 1 percent of commercial policyholders qualify for the exemption. Even at the $10,000 level, only about 10% of commercial policyholders are eligible for the exemption. Thus, even under the best circumstances, roughly 90% of commercial policyholders are subject to the current forms constraints. The subcommittee process should not result in picking winners or losers among commercial policyholders, but should make the benefits of free market competition available to all commercial insureds.

Turning to market conduct, the subcommittee's objective is to ensure nationwide, uniform adoption of a consensus market conduct law. The National Conference of Insurance Legislators (NCOIL) Market Conduct Surveillance Model Law is frequently cited as the model that should be the basis for national adoption. However, there are a number of improvements that must be made before that model can work as a standard. Foremost among these needed improvements is a "domestic deference" requirement. Domestic deference occurs where the state regulator in the jurisdiction where the insurer

is domiciled takes the lead on conducting an examination, and other states where the insurer is doing business defer to the lead state. Such a system, currently used for insurer financial examinations, would greatly reduce the number of duplicative market conduct examinations and would reduce insurer costs. Attempts to achieve domestic deference through NCOIL and the NAIC have failed. National uniformity and consistency of market conduct regulation must start with domestic deference.

On the subject of company licensing, the subcommittee envisions a single point-of-entry system based on uniform state adoption of the Accelerated Licensure Evaluation and Review Techniques (ALERT) developed by the NAIC. We agree that reform is necessary to avoid the overlapping, inconsistent, costly, and burdensome licensing standards employed by the states today. It makes little sense for national and regional companies to go through the licensing process in multiple jurisdictions. ALERT may be the appropriate vehicle to achieve national, uniform standards, but this process must undergo scrutiny at the congressional level to ensure that ALERT's translation as a national standard is not accompanied by onerous requirements.

Ultimately, the subcommittee's goals for policy forms review, market conduct regulation, and company licensing only can be achieved through strong national enforcement of preemptive federal standards. It is unrealistic – and raises significant constitutional problems – to expect the states to enforce federal standards, let alone to enforce them in a uniform and consistent manner. The industry's experience with the Gramm-Leach-Bliley Act of 1999 (GLBA) supplies ample evidence of the need for national oversight and dispute resolution. While GLBA established federal privacy standards for financial institutions, with implementation left to the functional regulators of those institutions, and the NAIC unanimously adopted a privacy model regulation, states like California, New Mexico, and Vermont have departed from that NAIC model, forcing insurers to comply with varying privacy standards and enforcement mechanisms. Indeed, even those states that looked to the NAIC model did so in piecemeal fashion or departed from the model in different, sometimes significant, ways. This maze of differing and inconsistent privacy standards made national uniformity impossible and made enterprise-wide privacy compliance difficult and costly. More importantly, it has led to consumer confusion over privacy protections, generated largely by the continuing changes in laws and regulations across the 50 states and the District of Columbia.

In addition, GLBA's registered agent and broker provisions were supposed to provide reciprocity on producer licensing in at least 29 jurisdictions, with the NAIC certifying that it had met the conditions of those provisions. Despite certification, key states are still not in compliance. Even those that have been certified by the NAIC still allow variances – extra requirements like fingerprint and background checks – before a non-resident license is granted. Moreover, if Congress merely enacts standards with no accompanying federal enforcement mechanism, it is all but inevitable that day-to-day interpretations and other ongoing regulatory matters will either be decided in court or, by default, be brought back to the subcommittee. For these reasons, we strongly encourage a national enforcement mechanism that can resolve disputes over the application of preemptive standards.

* * *

The subcommittee is tackling important and much-needed reforms in key areas of the state insurance regulatory system, and is to be commended for taking the initiative and inviting all constituencies to participate actively. Yet, reforms will only be worthwhile if they are bold, and are accompanied by an oversight mechanism that ensures national uniformity and consistency. A market-based regulatory system will eliminate needless paperwork and replace that red tape with efficient regulation that protects consumers by assuring that insurance companies are around when consumers need them most. Thank you for the opportunity to testify today, and I am happy to answer any questions the subcommittee might have.

TESTIMONY OF

DAVID F. WOODS, CLU, ChFC

Chief Executive Officer

National Association of Insurance and

Financial Advisors

And

President

Life and Health Insurance Foundation

For Education

Before the

Subcommittee on Capital Markets, Insurance

and Government Sponsored Enterprises

of the

House of Representatives

Committee on Financial Services

Regarding:

Working With State Regulators to Increase

Insurance Choices for Consumers

March 31, 2004

Chairman Baker, Ranking Member Kanjorski and Members of the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises: Thank you for the opportunity to submit testimony regarding insurance regulatory reform and the proposed plan to use federal legislation to bring about much-needed improvements to the state insurance regulatory system.

My name is David Woods. I am the Chief Executive Officer of the National Association of Insurance and Financial Advisors (NAIFA). NAIFA is a federation of approximately 800 state and local associations representing over 225,000 life and health insurance agents and advisors and their employees. Originally founded in 1890 as the National Association of Life Underwriters, NAIFA is the nation's oldest and largest trade association of life and health insurance agents and financial advisors. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of our members.

I have worked in the insurance industry for over forty years. I was a life insurance agent for thirty years and have been a member of the Million Dollar Round Table since 1970. I served as NAIFA President in 1986-87, meaning that I have been both a "volunteer" leader and chief of staff of this organization. I have also served on the Boards of Directors of both the Association for Advanced Life Underwriting and The American College, the premier educational institution of the life insurance industry. I was honored to be awarded the John Newton Russell Memorial Award in 1997 for outstanding service to the life insurance industry and my community.

In addition to serving as NAIFA's CEO, I currently serve as the President of the Life and Health Insurance Foundation for Education ("LIFE"). LIFE, a non-profit organization founded in 1994 by six life and health insurance agent organizations in the United States, was formed to address the growing need to educate the public about the essential role of life and health insurance in a sound financial plan and the value added by insurance agents and other financial advisors. LIFE is not a legislative advocacy organization.

My testimony will address insurance regulatory reform issues from the perspective of a life insurance agent. Life insurance agents generally sell products including standard life insurance policies, annuities, disability income and long-term care products.

Introduction

At the outset, I would like to commend you, Chairman Baker, and your colleagues for your focus on insurance regulatory reform, which is so important to insurance consumers, companies and producers, and to the Nation's economy as a whole. In the last several years, this Subcommittee has performed a remarkable service in conducting its series of oversight hearings examining the insurance marketplace and insurance regulatory structure. The hearings have brought to congressional attention issues that many players in the insurance industry - producers, companies, even regulators - have long-known are in need of modernization. This comprehensive and on-going process has shed light on many of the inefficiencies, idiosyncrasies, flaws, delays and redundancies associated with the current insurance regulatory system.

NAIFA believes it is imperative that the problems and inefficiencies in the state regulatory system be corrected quickly, and supports your active involvement in the reform process. Although the states have made solid efforts to improve the current regulatory system, and we strongly support their work, it has become increasingly clear that the state system needs help. There is a vital and immediate role that Congress can play in curing the problems of insurance regulation, and we believe the approach outlined by Chairman Oxley and Chairman Baker in recent weeks provides the conceptual framework for congressional action that will yield results in the near term benefiting insurance consumers, producers and companies.

My testimony this morning will focus on three areas:

- First, I will address the problems and deficiencies of the current insurance regulatory system from the perspective of life insurance agents;
- Second, I will explain the need for congressional involvement in insurance regulatory reform; and
- Third, I will discuss NAIFA's support for congressional efforts, including our wholehearted support for the regulatory reform proposal put forth by Chairman Baker and Chairman Oxley. I will also address NAIFA's policy position on regulatory reform, a position that has evolved over the past several years and fully embraces all efforts to improve the insurance regulatory system.

1. Meaningful Insurance Regulatory Reform is Necessary to Improve Problems in the Current System

There is widespread agreement that the state insurance regulatory system is in need of improvement in numerous areas and that reform is critical to protect consumers and ensure a strong and healthy insurance marketplace. Insurance producers and companies have been working with state insurance regulators for years to encourage sensible reforms to make the quilt of state insurance laws and regulations more uniform, thus enabling insurers and producers to better compete in an increasingly crowded financial services marketplace. Improvements in regulation benefit consumers, as well, who share the heavy burden of paying for the costs of complying with the current system.

The current problems facing state insurance regulation essentially fall into three categories: the duplicative producer and company licensing and post-licensure oversight processes, including financial regulation of companies and market conduct oversight; the length of time it takes to get a new product to market ("speed to market"); and the lack of a federal "presence" in insurance to interact with Congress and the executive branch.

a. Licensing and Duplicative Oversight

The problem with respect to the licensing of life insurance agents and brokers is the burden imposed by the requirement that producers be licensed in every state in which we conduct business. In order to obtain and maintain licenses, agents and brokers must comply with different and often inconsistent standards in numerous states and must contend with unnecessarily duplicative licensing processes.

Like producers, life insurance companies currently are required to be licensed in every state in which they offer insurance products, and the regulators in those states have an independent right to determine whether an insurer should be licensed, to audit its financial solvency and market conduct practices, to review mergers and acquisitions, and to dictate how the insurer should be governed.

With the exception of market conduct examinations, it is difficult to discern how the great cost of this duplicative regulatory oversight is justified, especially in light of the fact that the underlying solvency requirements are essentially identical from state to state. Market conduct examinations present a somewhat more difficult issue because, although the majority of sales and claims practices requirements and prohibitions are similar across the country, there are local variations. It is, of course, difficult for a regulator to determine compliance with another jurisdiction's requirements. At the same time, it seems wholly unnecessary for each regulator to examine every insurer on every aspect of their compliance practices given that there is such an extensive overlap in requirements.

b. Speed to Market

While "speed to market" - the ability of life insurers to get products approved and available to consumers in a timely fashion - appears to affect companies more than insurance producers, we would argue that the restraints imposed by the state-by-state regulatory system in this area harms agents as much as companies because they negatively affect the availability and affordability of insurance, and, thus, our ability to provide the new and innovative products that respond to identified needs in the marketplace. The reality of today's marketplace is that banking institutions and securities firms currently are able to market new and more innovative products and services immediately, while the life insurance industry is hampered by lengthy and complicated filings and approvals in all fifty states. As a result, life insurance companies - and, derivatively, agents and brokers selling their products and services - are at a significant competitive disadvantage compared to their counterparts in other financial services industries.

Today, life insurance policy forms are subject to some form of regulatory review in nearly every state, and the manner in which forms are approved and otherwise regulated can differ dramatically from state to state and from one life insurance product to the next. While most insurance codes provide that policy forms must comply with state laws, promote fairness, and be in the public interest, there are a multitude of ways in which states currently regulate forms. These systems include prior approval, file and use, use and file, and self-certification. These requirements are important because they not only affect the products that can be sold, but also the timing of product changes in today's competitive and dynamic marketplace.

The current approval system, which may involve seeking approval for a new product or service in up to fifty-five different jurisdictions, is too often inefficient, paper intensive, time-consuming, arbitrary, expensive and inconsistent with the advance of technology and the regulatory reforms made in other industries. It often takes two years or more to obtain regulatory approval to bring new products to market on a national basis. Cumbersome inefficiencies create opportunity costs, and this regulatory regime is likely responsible for driving many consumers into alternative market mechanisms. As a result, the costs of insurance regulation are exceeding what is necessary to protect the public.

c. Federal Insurance Presence

The lack of a federal presence in insurance is a significant handicap for the life insurance industry. This was aptly demonstrated following the terrorist attacks of September 11, 2001. With no presence in Washington, there was no insurance regulatory authority to work with the Administration and federal agencies to communicate and coordinate response to the attacks. In addition, there was no federal expert to turn to as Congress and the Administration debated the need for federal terrorism insurance coverage and enacted the Terrorism Risk Insurance Act (TRIA). Although the NAIC and state regulators were impressive in their reaction to 9/11 and assisted in the development of TRIA, the diffuse nature of the state system does not easily translate into expert authority at the federal level.

While TRIA illustrates the need for property and casualty expertise at the federal level, the victims' compensation fund, also passed in reaction to September 11, shows the need for a federal insurance presence on the life insurance side of the industry. The victims' compensation fund was added as a last minute provision to the airline stabilization bill that was enacted after 9/11. The compensation fund provision was introduced, debated and passed in just one day - with little debate and no committee consideration at all. Congress gave no notice of its intent to include this provision and sought no expert advice as to its ramifications. The law arbitrarily specifies that life insurance and

pensions are the sole collateral sources that must be deducted from any compensation a victim's family otherwise receives or is entitled to receive under the fund. No other collateral sources, such as bank accounts, stocks and bonds, mutual funds or inheritances, are included. NAIFA believes it is fundamentally wrong to penalize people who have prudently chosen to protect their families and plan for their financial security. We believe if Congress had a life insurance expert at the federal level to consult, the legislation's illogical result would have been much less likely.

Life insurance is a rapidly evolving industry, with new and innovative products coming to market as rapidly as regulation will allow. We find, however, that life products not only have to jump the regulatory hurdles imposed by the states, but also face roadblocks at the federal level, mostly in the form of tax policy. We find that, year in and year out, life insurance products are routinely disfavored in tax legislation as compared with comparable banking and securities products. For example, this year, the Administration has proposed creation of Lifetime Savings Accounts (LSAs), which are tax-favored savings accounts designed to encourage consumer saving. The tax advantages granted to LSAs are designed to make those products more appealing, but at the expense of insurance products currently in the market that do not receive the same tax benefits.

We believe this differential treatment is not due to animosity toward the insurance industry or insurance products, but due to a lack of understanding of the impact of these federal actions on life products. An expert at the federal level of government would be able to educate policymakers so that the implications of their decisions on the insurance market are well understood. In addition, a federal presence could serve an important role in international and trade issues, where it is important to speak with one voice. Banking and securities regulators currently serve this role with respect to the industries they regulate, and we believe it is sensible to add an insurance voice to the mix.

2. Congressional Involvement Would Help State Reform Efforts

Although state insurance regulators have made great efforts in the past several years to reform and modernize the system, the necessary improvements have not been made. Insurance regulation has failed to adapt to changes in the industry and the markets it serves, resulting in the significant regulatory deficiencies that exist today. Unnecessary distinctions among the states and inconsistencies within the states thwart competition, reduce predictability and add unnecessary expenses to the cost of doing business. Similarly, outdated rules and practices do not serve the goals of regulation in today's converging financial services marketplace.

To their credit, the state insurance regulators have recognized to some degree the need to improve and modernize the insurance regulatory system currently under their control. Ernst Csiszar, the South Carolina Insurance Director and current President of the National Association of Insurance Commissioners (NAIC), has acknowledged publicly that change is needed and that holding the regulators' "feet to the fire" could lead to improvements in the regulatory system. The Commissioners have adopted an "Action Plan for Regulatory Modernization" that outlines their plan for reform.

Despite their good intentions, however, the commissioners' action plan is limited in scope and sparse on details. It is unclear what the states will accomplish or how long it will take to achieve the reforms that are so important for the insurance marketplace. Even for those initiatives that are clearly addressed in the action plan, the commissioners' ultimate goal is less than ambitious. For example, the state regulators have drafted an interstate compact establishing a single point of filing for regulatory review and approval of certain life, annuity, disability income and long-term care insurance

products. This is extremely important to NAIFA members, and NAIFA supports the compact wholeheartedly. However, we are disheartened to note that its implementation is not on a fast track. Very few states have adopted the compact and obtaining enactment of the compact in every state in a timely fashion, if ever, presents a very challenging legislative obstacle. Moreover, even if the compact is someday adopted in a substantial number of states, the compact itself permits states to opt-out of particular products, which would undermine the uniformity that is needed in the product approval process. These circumstances lead us to conclude that congressional involvement in the reform effort could help improve the regulatory environment.

Despite heroic efforts, it has proved to be very difficult for state regulators and their legislatures to unilaterally correct the identified deficiencies in state insurance regulation. Both practical and political realities dictate that, if identical bills are proposed in 50 state legislatures, 50 different bills will emerge from those 50 separate legislative processes. There are numerous reasons for this lack of success - lack of will, disagreements over substantive details, structural impediments, and the fact that it is simply very difficult to get 50 different jurisdictions to act in a coordinated fashion - and act quickly in a constantly changing global marketplace.

3. NAIFA Supports Congressional Efforts to Reform Insurance Regulatory System

The title of today's hearing - "Working with State Regulators to Increase Choices for Consumers" - encapsulates NAIFA's approach to regulatory reform. We are long-time supporters of state regulation, and remain steadfastly committed to this tradition. We believe, as others do, that fixing the problems with the insurance regulatory system will yield a strong and healthy insurance marketplace, ultimately providing better and greater choices for consumers.

Having said that, as I have made clear in my testimony thus far, we also recognize the challenges facing state regulators in their efforts to achieve reform. In addition, the changing dynamics of the financial services industry in the 21st century compel NAIFA to be open to all promising options to improve the regulation of the industry.

a. NAIFA's Policy on Insurance Regulatory Reform

Since 2002, NAIFA policy has supported congressional action to improve and augment the regulation of insurance, provided such action meets NAIFA's specific guidelines aimed at maintaining fairness to agents and protection for the consumers they serve. Early this year, we clarified this policy to highlight our support for the NAIC's regulatory modernization action plan and to identify certain federal proposals that could, if properly crafted, improve the regulation of our industry. A copy of our current Insurance Regulatory Reform Policy is attached as Addendum A.

While our regulatory reform policy continues our century-long support for state regulation of insurance and confirms our commitment to improve the state-based system, we believe the status quo of insurance regulation is detrimental to consumers and NAIFA members. Thus, the recent strengthening of the policy was necessary to acknowledge that all options are on the table and that NAIFA is willing to consider a breadth of alternatives in our desire to fix the problems confronting us. As a result, we have adopted a policy that embraces federal initiatives to improve the regulation of insurance. Based on our conceptual understanding of the Chairman's proposal, we believe the regulatory reform efforts of the Subcommittee will fall squarely within our policy.

Subsequent to our action strengthening the regulatory reform policy, you may have heard reports that

NAIFA favors federal regulation over state regulation of insurance. That is not the case. NAIFA simply favors reform, improvement and progress over the status quo. NAIFA policy does not contemplate support for any federal action that would displace the state system. That is why the Chairman's proposal, conceptually, is so appealing: the proposal works within the state structure using federal law to bolster state action to address the most critical regulatory issues.

b. NAIFA Supports the Regulatory Reform Proposal

NAIFA supports the regulatory reform approach outlined by Chairmen Oxley and Baker. The concepts embodied in the approach are in keeping with NAIFA's policy on insurance regulatory reform and we believe the approach holds the potential for achieving real change and real improvement in a timely fashion. The concept is appealing because it relies on the best elements of the current state structure - the regulators' expertise and coordinated action through the NAIC - to help improve the worst problems confronting the system, including licensing and speed to market issues, and forces all the states to take action. This partnership with the states could bring quick progress to areas where the states have been unable or unwilling to act on their own - or where they have been unable or unwilling to act quickly and uniformly.

We support the major provisions of the proposal as broadly outlined, including licensing, speed to market, and market conduct reform. We also support creation of a federal regulatory presence in insurance so the federal government has a knowledgeable voice to turn to on issues that affect insurance consumers and the industry.

While we support the Chairmen's approach conceptually, the devil, of course, is in the details. In order to satisfy NAIFA's regulatory reform policy, any reform proposal will be required to meet the core principles that NAIFA has long promoted for a well-regulated industry. The core principles, which are listed in full in Addendum A, address issues such as producer licensing, rate and form filing and approvals, and consumer protection.

- Producer Licensing: A great majority of producers now operate in more than one state. As NAIFA and others have described to you many times, it is cumbersome, time consuming and expensive to file for and maintain licenses in multiple jurisdictions. The states have made good progress in establishing reciprocal licensing laws, but more action is needed to make the licensing system truly uniform.

  NAIFA believes that all duplicative licensing requirements should be eliminated to ensure that each insurance producer will be required to demonstrate to only one regulator that he or she is qualified to receive a license to engage in insurance. In addition, uniform substantive and procedural licensing requirements should be established for each class of similarly situated producers, and uniform continuing education requirements should be established for similarly situated producers. Producers should be required to satisfy only a single set of continuing education requirements for each line of business.

  In addition, NAIFA's principles support the mandated performance of a criminal background check on all applicants for licensure, as well as creation of a financial services regulator database to ensure that individuals who have committed fraud or engaged in other behavior that should bar their participation in the business of insurance are identified and tracked. The

Subcommittee has considered legislation along these lines in the past.

- Speed to Market: As I described above, life insurance companies currently are required to file their policies in and be approved by any state in which they offer those policies. This can, and often does, take months or even years, while competing products offered by banks and securities firms can be on the market in a matter of days. Insurers are thus unable to compete, and consumers are deprived of potentially helpful insurance products.

NAIFA supports the NAIC's interstate compact and believes that all duplicative filing and approval requirements should be eliminated, and uniform filing and approval requirements should be established.

- Consumer Protections: NAIFA believes that uniform trade practices and consumer protection requirements should apply to all insurance sales and service activities. In addition, regulators' responsiveness and accessibility to consumers must be preserved.

We believe that the regulatory reform proposal put forth by the Chairmen is consistent with these core principles and that the principles can be embodied in any legislation developed under the broad contours of the proposal as outlined. We appreciate the Subcommittee's hard work on this issue and your willingness to work with all of us who have a strong interest in improving the currently regulatory structure. We look forward to working with you and your staff in crafting legislation that will improve the insurance regulatory system for the good of consumers, NAIFA members, and the insurance marketplace as a whole.

# # #

Addendum A

NAIFA Policy on Insurance Regulatory Reform

NAIFA supports the principles underlying state regulation of the business of insurance and efforts to improve the state-based system of insurance regulation, including support for the National Association of Insurance Commissioners' Action Plan for Regulatory Modernization. NAIFA also supports congressional initiatives to improve and augment the regulation of the business of insurance, such as the creation of a federal insurance regulator, optional federal charters for insurance companies and agencies, a national producer's license for insurance professionals, and other federal efforts to improve the insurance regulatory system. NAIFA supports reform of the insurance regulatory system that meets the following guidelines:

1. With respect to producer licensing and continuing education requirements:

- All insurance producers must be licensed.
- All duplicative licensing requirements should be eliminated to ensure that each insurance producer will be required to demonstrate to only one regulator that he/she is qualified to receive a license to engage in insurance representing either a state chartered or federally chartered insurer.
- Uniform substantive and procedural licensing requirements should be established for each class of similarly situated producers.
- The uniform licensing requirements should include the mandated performance of a criminal background check on all applicants for licensure.
- A database to which only financial services regulators have access should be established to help ensure that individuals who have committed fraud or engaged in other behavior which should bar their participation in the business of insurance are identified and tracked.
- Each insurance producer should need to satisfy only a single set of continuing education requirements for each line of business for which he/she is licensed.
- Uniform continuing education requirements should be established for each class of similarly situated producers.

2. With respect to other consumer protection requirements:

- The tax incentives supporting life and other insurance products must be preserved.
- Uniform trade practices and consumer protection requirements should apply to all insurance sales and service activities.
- Adequate solvency requirements for insurers must be in place such as guarantee funds or comparable fail safe mechanisms.
- Regulators' responsiveness and accessibility to consumers must be preserved.

3. With respect to rate and form filing and approval requirements:

- Duplicative filing and approval requirements should be eliminated.
- Uniform filing and approval requirements should be established.
- "Quality to market" concerns should not be sacrificed for "speed to market."

4. With respect to changes in regulatory rules, structures and procedures:

- Current regulatory expertise should be preserved to the maximum extent possible as consistent with efficient regulation.
- Any "reform" should be viable for both accumulation and risk-shifting products.
- Submission to the jurisdiction of any additional newly created regulatory authority should be truly optional for all producers.
- Producers should have an institutionalized role in the development and application of all new regulatory rules, structures and procedures.

- Approved by the NAIFA Board of Trustees 1/16/04

TESTIMONY OF

SENATOR E. BENJAMIN NELSON OF NEBRASKA

SUBMITTED TO THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND GOVERNMENT
SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES
UNITED STATE HOUSE OF REPRESENTATIVES

"ROADMAP TO STATE-BASED
INSURANCE REGULATORY RESTRUCTURING"

MARCH 31, 2004

Mr. Chairman and Members of the Subcommittee:

I am Senator Ben Nelson and I represent the State of Nebraska. As a former state insurance regulator, former executive director of the National Association of Insurance Commissioners, and a former chief executive of several insurance companies, I know the insurance industry from several vantage points. And as a former governor, I have a good understanding of the ways in which the federal government and state governments can work together, both for better and, unfortunately, for worse. I appreciate this opportunity to offer my thoughts as you begin to examine the current state of the industry and the traditional state-based regulation of that important economic engine.

First of all, Mr. Chairman, I applaud you, and also the Chair of the full Financial Services Committee, for your willingness to focus on these important issues. While the subject of insurance may seem somewhat mundane to many, I know that you and the members of this subcommittee and the full committee appreciate the importance of the industry, both as the provider of products which offer security to the nation's families and businesses, and as the prime provider of investment capital needed to build and sustain our national economy.

Going back to the 1940s, with the adoption of the McCarran-Ferguson Act, Congress has recognized that the regulation of the insurance industry is best left to the states. That regulatory approach has served the public well over these past sixty years. States have been able to fashion and refine a regulatory scheme that best suits their unique circumstances and meets the needs of their citizens. Insurance companies have been able to form, to grow and develop the insurance products necessary to provide protection for families, their lives and livelihoods, their health, their homes, their businesses and their possessions. State regulation has ensured that those companies were there, solid and solvent, to make good on the claims of policyholders in times of loss. State regulation has given consumers confidence that they are treated fairly in rate setting and claims processes. And as the industry has grown, in this state-regulated environment, it has provided the necessary capital to fuel economic growth and prosperity, helping to create jobs and make this the strongest economy in the world. The insurance industry is an American success story. And state regulation has been a large part of that success.

While state regulation has been successful, I am not here to say that it has been perfect. There are inefficiencies in a system which requires companies to conform to fifty different regulatory schemes. Uniformity and standardization among the fifty states have been difficult to achieve, for a variety of reasons. For many years, state regulators may not have fully appreciated the need for this standardization. But with the increasing complexity of the industry, and ever-increasing competition to bring new financial products to market, state regulators have come to recognize the need to streamline the regulatory structure. I applaud the current leadership of the National Association of Insurance Commissioners, Director Ernie Csiszar and Commissioners Greg Serio of New York and Mike Pickens of Arkansas, for their initiative in bringing together state regulators in support of a comprehensive modernization plan, a realistic and achievable regulatory framework to guide the states as they move to make state regulation even more responsive to the needs of their citizens and the insurance companies which provide them with financial protection. And I applaud the leadership of this committee for their willingness to

reach out and work with the nation's commissioners. I know that Chairman Oxley met with the leadership recently to pledge his cooperation and seek their input as these concepts are fleshed out. I am pleased to see a solid working partnership developing, and I encourage you to continue in that spirit.

This committee is aware, I'm sure, of the NAIC's efforts of the past few years. In March of 2000, the organization issued a statement of intent to modernize and streamline the state regulatory process. A great deal of work was done in the intervening time to establish a process and lay the foundation for a comprehensive plan. In June of 2003, I appeared before the group to encourage their efforts, and in September of last year they came forward with the plan, ***Reinforced Commitment: Insurance Regulatory Action Plan***, a landmark document, setting forth a realistic plan, with a timeline for implementing changes, and an overall goal of completing the modernization process by December, 2008. Mr. Chairman, they are on target, and in fact, ahead of schedule, in implementing those changes. I urge this committee to give these industry modernization initiatives time to work.

I have followed the discussions which may lead up to legislation here in the House by the Committee chairman and others on the Committee. This "federal tools" proposal, as I understand it, makes clear that we all share many of the same goals. There are many concepts contained in the proposal that I believe the NAIC can and will support. Encouragement and assistance to the state regulators, their legislatures and their governors, can be helpful, and I believe state regulators will embrace many aspects of the proposal.

Of course, the Committee has only begun to explore this issue. Nothing has yet been put in stone. No legislative language has as yet been offered. This is still in the conceptual stage. But in some respects, based on what I understand is being contemplated in the proposal, it may go too far in some areas. For example, sweeping mandatory federal standards, however well-intentioned, cannot take into account the differences among the states and the need for regulation tailored to the needs of policyholders in the individual states. And a federal office of insurance, overseeing implementation of those one-size-fits-all mandates, can only create confusion and frustration, both within the industry and on the part of policyholders. We don't want the only "tool" in the federal "toolbox" to be a hammer.

I know that there are those in Congress who are considering deregulation of rates on personal lines. And I know that many in the industry whose judgment and business acumen I respect will be supporting that approach. Mr. Chairman, rate regulation for personal lines has helped tremendously over the years to keep the cost of coverage down for America's families, and to assure consumers that the rate-setting process is fair and reasonable. While I can appreciate the industry's desire to eliminate state oversight of rates, I urge this committee to proceed with the utmost caution in any effort to alter this critical aspect of state regulatory authority.

Mr. Chairman, as governor of Nebraska for eight years, I am all too familiar with federally-imposed mandates, and I have a very healthy skepticism when it comes to them. In the area of insurance regulation, particularly, even if the state regulators support the thrust of the mandates, they must persuade their legislatures, and their governors, to support enacting legislation. Sometimes it's hard to turn the battleship around. It takes time and an appreciation of the need

to act on the part of elected policymakers at the state level for these changes to be put into place. For the Congress to place yet another unnecessary and unworkable layer of federal bureaucracy on the states would, in my opinion, be most unwise. States are moving forward, as the Commissioners will tell you in their testimony later today, without these heavy-handed mandates.

As the leadership of the National Association of Insurance Commissioners will testify today, I believe we all share the same goals. Of course, the first consideration must be, as it always has been, the safety and solvency of the industry, the responsibility of companies to meet their obligations to the policyholder. That is the fundamental underpinning of the industry, the basis for its very existence. That basic protection has been the primary responsibility of state regulators, and they have met that responsibility consistently through the years. Safety and solvency, the protection of the consumer, must remain the paramount consideration in any regulatory scheme.

Standardizing and streamlining the regulatory process will result in lower costs of doing business for the industry, and broader and better protections for consumers of insurance products. But, as in so many areas that we in the Congress deal with, the devil's in the details. How the Congress moves forward to meet these articulated goals will be critical to the future of the industry and its ability to provide the products to protect policyholders.

The states have already adopted a number of standardization tools, and these tools have been effective in reducing the regulatory burden without compromising safety and solvency. Interstate compacts have worked well, for example, in establishing a single-point filing system for life insurance products. Standardization of filing requirements and forms for insurers seeking licensure has helped to simplify and expedite that process. NAIC is codifying best practices and procedures for assessing licensing applications, adding consistency to the process. And the NAIC is helping states to adopt a nationwide and uniform consensus market conduct law, again, based on proven best practices.

Mr. Chairman, the state regulators are energized. Significant progress is being made. All of us, the industry, the regulators, policyholders, and elected officials here in Washington and at the state level, recognize the need to standardize and streamline the regulatory framework to meet the needs of the modern financial environment. Congress can be helpful in this important process, and I applaud you and the members of this committee for your willingness to work with the state regulators in this important effort. But I believe that we must move carefully as this process goes forward. The basic framework of state regulation of the industry has worked over these many years, and I hope to be a part of making state regulation work even more efficiently and effectively.

Again, Mr. Chairman and members of the subcommittee, I appreciate having the opportunity to offer my thoughts on this important issue, and I stand ready to assist you in assisting the states as they move forward to modernize their regulatory processes.

Statement

of the

Property Casualty Insurers Association of America

to the

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

March 31, 2004

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to present its views on insurance regulatory reform. PCI, the nation's premier property/casualty insurance trade association, was formed in January 2004 through the merger of the National Association of Independent Insurers (NAII) and the Alliance of American Insurers (Alliance), both of which have long histories of association with the subcommittee. The mission of PCI is to foster a competitive insurance marketplace for the benefit of insurers and consumers and to provide a responsible and effective voice on public policy questions affecting insurance products and service.

PCI's members write $154 billion in annual premiums, or 38 percent of the nation's property/casualty insurance. Member companies range in size from billion-dollar national companies to multi-line regional groups to single-state and niche/specialty writers. They include mutuals, stock companies, reciprocals, surplus line carriers and risk retention groups. PCI represents the broadest cross-section of insurers of any national trade association.

PCI members transact most types of property/casualty insurance business, using every type of distribution system. Our members are domiciled in 49 of the 50 states, write coverage in all states and the District of Columbia, and have facilities, employees and policyholders spanning the country. This diversity in membership provides PCI with a unique perspective on insurance regulation.

While PCI members serve a wide variety of personal and business insurance consumers and market their products in many different ways, our companies share the same common vision that competition and market-oriented regulation are in the best interest of the industry and the customers they serve. As reflected in our mission statement, PCI's primary goal in pursuing regulatory modernization is to promote competitive markets and ensure reasonable, efficient and effective regulation.

PCI member companies strive to provide the highest quality products and services to the nation's insurance consumers. Consumers deserve a marketplace that reflects their needs and lifestyles, adapts to changes throughout the years and affords the greatest possible range of choices, while protecting policyholders against insurer insolvency and fraud. PCI member companies support a regulatory environment that allows insurers to offer varied policy choices at a competitive rate. Insurers must also have the ability to adjust policy terms, pricing structures, delivery channels and customer service methods to meet consumer demands and expectations.

PCI members agree with the large majority of insurers, agents, regulators, state legislators and members of Congress that the current insurance regulatory system must improve. Meaningful reforms, which reflect the way business is conducted and are adaptable to the changing business environment, must be adopted. Current regulatory systems frequently cause delays in new product offerings for consumers and impose needless, and costly, rate approval processes. In some states, the company and agent licensing processes are also lengthy and cumbersome. Conversely, in other states, the market withdrawal process is bureaucratic and punitive in nature. Financial and market

conduct examinations are often disjointed and inefficient, and suffer from a lack of coordination. These areas of state regulation must be improved and simplified, and greater uniformity must be achieved. Subcommittee Chairman Richard Baker (R-La.) has proposed a series of federal initiatives designed to address these crucial issues.

PCI commends Chairman Baker for his dedication to improving insurance regulation. The subcommittee has conducted more than a dozen hearings and roundtables examining the regulatory environment and determining areas for reform. Throughout the process, the overriding theme of testimony from a wide array of witnesses is the substantial benefit to consumers of competitive insurance markets.

NAII and the Alliance, along with our member companies, were appreciative of the opportunity to participate in the subcommittee's examination and PCI is pleased to continue to offer its views here today. Rather than address specific components of Chairman Baker's outline, PCI is pleased to offer comments on the scope and direction of the chairman's proposal and the association's general policy position on regulatory reform issues.

PCI recognizes Chairman Baker's goal of strengthening and improving the state regulatory system. First and foremost, PCI believes that the greatest chance to achieve this goal, both politically and functionally, is a narrowly targeted package designed to address the core problems of the current regulatory system – namely antiquated price controls that impose barriers to market-based pricing systems. While other areas of reform are important, the single most significant element overshadowing all other reform proposals is the goal of insuring a truly competitive marketplace with open rate competition. On behalf of our members and policyholders, PCI urges the subcommittee to place the highest priority on competitive market reforms and focus its legislative effort in this direction.

In addition, PCI urges the subcommittee to reaffirm, as Congress did in the Gramm-Leach-Bliley Act, the doctrine of state regulation of insurance embodied in the McCarran-Ferguson Act as part of any reform measure.

Competitive Marketplaces

A marketplace in which competition is the primary regulator of insurance rates best serves consumers, regulators and insurers. Competitive insurance markets afford consumers the greatest choice among service providers, pricing options and insurance products. PCI fully agrees with full committee Chairman Mike Oxley's observation that "without change, consumers face a world with fewer options, less competition, and less available coverage."

Unfortunately, many states still attempt to control prices by requiring insurance companies to get "prior approval" from insurance regulators before adjusting their rates up or down. This strict regulatory method remains in place because of the political pressure to give the appearance of control over, or reduction of, insurance prices.

However, experience shows that prior approval systems make rates more susceptible to political manipulation and that consumers in states with prior approval regulation ultimately end up with fewer insurance companies to choose from and may pay more for their policies.

Political manipulation of rates can take various forms including outright disapproval of individual company rate filings. Regulators may also disapprove use of particular classification plans, rate factors and even discounts. In some states there are regulatory limits on the differences that can be charged in one territory versus another. This can distort cost-based pricing and lead to subsidies. When regulators prevent insurers from charging policyholders premiums based on rating criteria determined by the insurers, regulators interfere with market freedom. All this political manipulation stifles innovation, leads to higher residual market populations, discourages competition and ultimately hurts consumers.

Nor are laws that provide for file-and-use or use-and-file necessarily a panacea. Often, insurers are unable to use a filed rate for fear that the state might disapprove the rate sometime in the future. Worse, an insurer relying on a filing without the approval from a state might be required to disgorge the difference should the new rate later be disapproved. Thus, when PCI speaks of "prior approval" in these comments, we refer to onerous regulatory controls that can be imposed on any filing system.

Like our predecessor organizations, PCI continues to believe that the most desirable regulation of insurance is that which achieves a competitive insurance marketplace. However, regulatory systems in some states have failed in recent years to adapt to changes in both the industry and the marketplace they oversee. Many state regulatory systems have become bloated and inefficient. The expansion of regulatory requirements combined with the lack of uniformity epitomizes regulatory inefficiency. To achieve the goal of market competition for all consumers, regulatory impediments must be eliminated. PCI believes that regulatory rules, procedures and philosophies should be directed toward stimulating market competition, not impeding it, and insurance regulatory systems should be structured to encourage the natural infusion of private capital into the industry.

Regulation of rates and forms is the most critical element of insurance regulatory reform for the property/casualty industry. Excessive governmental interference and control in the development of rates and forms are the prime drivers of the call for regulatory modernization by property/casualty insurers.

PCI supports open competition rating laws as the most desirable approach to rate regulation for the entire industry. Studies verify that consumers in states where competition is the primary regulator of price benefit from expanded choice, innovative pricing and improved insurance availability.

Therefore, PCI supports pure competition-based regulatory systems, as exemplified by the Illinois model. For example, Illinois, which has had competition-based rating since 1971, has an exceptionally healthy personal lines insurance market. Many insurers

compete for business in all parts of the state – including major urban areas. In fact, there are 224 insurance companies domiciled in Illinois alone, while more than 500 carriers write auto insurance. Without a doubt, the open competition rating law has worked successfully for Illinois consumers. Given its population size and concentration, traffic density, housing values, and other factors affecting losses, Illinois would normally be expected to rank among the top ten states for insurance costs, yet it repeatedly remains in the middle range among all states for auto and homeowners prices. In addition, the auto assigned risk pool comprised of consumers who, because of poor loss histories, cannot find insurance in the standard market is extremely low: one-tenth of one percent. Consumers in every state would similarly benefit from the adoption of competitive market systems.

While Illinois has a long history with competitive markets, more recently South Carolina has shown that competitive market reforms produce significant benefits for consumers. In 1999, the state abandoned its prior approval system. Since this change, 105 auto insurers have entered the market, average auto insurance rates have decreased and the state's residual market plan has declined to fewer than 600 drivers, compared to the more than 750,000 drivers it serviced less than a decade ago. The end result is that the system is more fair and responsive and meets the need of consumers, regulators and insurers.

These examples stand in stark contrast to the experience of consumers in other states, such as Massachusetts. The subcommittee has heard extensive testimony on the regulatory failures of the Massachusetts system and the consequences to consumers. This state has a poorly working regulatory system which includes excessive regulation of rates, forms and underwriting that has discouraged new companies from entering the market and led to a decrease in choices available to consumers. By law, the insurance commissioner in Massachusetts mandates rates that must be utilized by all insurers, with only limited deviations permitted. In addition, state statutes prescribe the precise form of coverage that must be made available to all consumers. This over-regulation in the state has driven insurers out of the market and caused unprecedented growth in the residual market. Moreover, the regulation of the residual market itself has worked to deny consumers choice by driving away carriers.

As evidence of Massachusetts' regulatory failure we need only look to the number of insurers domiciled or operating in the state. The number of domiciled companies is one of the lowest in the country. Moreover, the number of licensed auto insurers is 45 percent lower than the average number of auto carriers doing business in the states throughout the nation. Given the state's number of drivers, this quantity is remarkably low and very disconcerting. As a result, the Massachusetts Commonwealth Automobile Reinsurers (CAR) system, which distributes high-risk policyholders among participating companies, remains a concern in this state. CAR and the accompanying state-established rate process have produced a non-competitive market with a disproportionately low number of auto insurers doing business in the state and an unhealthy concentration of business among only a handful of writers.

Opponents of competition-based rating have the misguided impression that a prior approval system keeps insurance rates down. In fact, it is competition that keeps rates down. Prior approval systems require regulators to inefficiently use their time to review and approve rates that are governed by competition and have adverse consequences for consumers, when that time would be better spent in solvency review to assure that the promise is met.

PCI encourages the subcommittee to take an aggressive position with respect to rate and form regulation and to make this element the prime focus of any reform effort. To improve insurance regulation for consumers, regulatory half-measures are not as effective as comprehensive rate regulatory reform for all property/casualty lines. Attempts to enact "stepping stone" systems will not provide the tangible benefits to consumers of pure competition based models. To ensure the fullest benefits to consumers across the nation, PCI strongly urges the Chairman and members of the subcommittee to insist on inclusion of the strongest open competition provisions in any reform legislation.

Similarly, form regulation should be based on market principles. Innovation should be encouraged by any regulatory scheme. Form filings also should be competitively based, i.e., informational only. The objectives of achieving regulatory modernization on forms are the same as for rates: choice, convenience and innovation. External factors driving insurance market conditions affect insurance contracts as much as insurance pricing. Property/casualty insurers must be able to bring new products to market and adjust previously introduced contract forms to market changes and conditions in an expedient manner.

Unfortunately, the current filing and approval processes among states are often quite different and introduce unnecessary complexity, delay and cost for property/casualty insurers. Inefficiencies in the system stifle product innovation, reduce competition and increase costs to consumers. Form regulation, like rate oversight, should be predicated on the concepts of information and disclosure. The goal of form regulation should be to ensure consumer access to information and facilitate development and marketing of new products.

To ensure effective and competitive markets, it is necessary to guarantee access by all insurers to credible data, including companies that operate as single-state insurers, or regional writers transacting business in a limited number of states. Because of smaller books of business, these companies are not always able to develop actuarially credible rating information through their internal loss experience alone. They depend on the availability of aggregated prospective loss cost data in order to develop rates. Without this loss cost information, these companies would be unable to compete effectively with companies who serve these markets, limiting consumer choice. Furthermore, a start-up insurer or an insurer entering a line of business for the first time will not have any credible data of its own to utilize. Access to loss data is critical for market entry.

In addition, many property/casualty insurers (both large and small) rely on the availability of supplemental rating information developed by licensed advisory

organizations such as the Insurance Services Offices (ISO) to price their products. This advisory information would not be available if all insurance companies do not report data or are constrained from reporting data as the result of antitrust law exposure. The McCarran-Ferguson Act provides a limited antitrust exemption under which statistical agents can collect data, and insurance companies can pool and use aggregated loss data.

The availability and reliability of loss cost data is essential to the effective operation of competitive insurance markets. In the absence of such data, all but a few insurers would confront increased operating expenses. Access to accurate and reliable data would become a barrier to market entry. Over time, it could threaten the small company franchise, prevent new entrants into the insurance industry and have a chilling effect on the ability of existing insurers to expand into new markets or new product lines, ultimately reducing consumer choice.

It is imperative that any reform proposal retain the antitrust exemption for loss cost data and continue to require the submission of data by all insurers.

Additional Market Reforms

In addition to the competitive market provisions of the proposal, Chairman Baker has identified a number of areas for reform including market conduct, company and producer licensing and elimination of desk drawer rules. As we have previously noted, these other areas of reform are important, but their impact on improving the insurance marketplace pales in comparison to the value of competitive market reforms. We commend Chairman Baker for proposing additional procedural reforms, but encourage the committee to focus its efforts on rate and form reforms.

We appreciate the chairman's efforts to pursue a coordinated system of standardized market conduct review based on market analysis to identify patterns of abuse and on-sight review of company systems and controls. PCI believes that market analysis must be the cornerstone of any market conduct action to allow states to target their limited resources on the most significant problems. It is also imperative that the standard for review in any market conduct action must be the laws and regulations in effect at the time of the conduct being examined. It is illogical and unproductive to attempt to examine insurers for compliance with rules and regulations that did not exist during the period of the examination. To address problems in the current market conduct examination system, it is also essential that insurers be provided with effective due process protections, including independent arbitration procedures.

With respect to licensing, PCI believes that important reforms of producer licensing laws are necessary and achievable. In response to prior congressional action, many states have moved toward reciprocity; however, failure to participate by several large-market states has reduced the efficiencies hoped for with the adoption of the federal standards. There is broad support among producers, carriers, consumers and regulators to take the next steps beyond the mandates of Gramm-Leach-Bliley and move toward a national approach to ensure full reciprocity for producer licensing across all 50 states in producer licensing. From a company licensing perspective, varying state standards can serve as a market

entry impediment. It can take a company wishing to become licensed in all 50 states over a decade to complete the process. These delays reduce markets for new products, impede competition for products and limit consumer choice. As a result, PCI supports efforts to streamline market entry.

Another particular area of frustration and concern for PCI members is the existence of regulatory rules that have not been codified or formally adopted through regulatory proceedings, often referred to as "desk drawer rules." Insurance companies are not in a position to know what the desk drawer standards are in advance of their application for a license or rate or form filing, nor are they kept abreast of revisions, should they occur. In fact, the authority for these standards is often lacking or questionable. Application of these unpublished and unpredictable procedural requirements often serve as barriers to market entry and thwart the efforts of insurers to offer new products and services for consumers. Furthermore, it is impossible for insurers to make meaningful business and operational decisions when they are in danger of violating unwritten rules. Chairman Baker proposes to eliminate these so-called "desk drawer" rules. PCI supports efforts to outlaw such inefficient and arbitrary obstacles to effective market operation, but suggests that the most efficient way to eliminate "desk drawer" rules is by implementation of competitive market principles. By definition, there can be no desk drawer rules for rates and forms in a competitive market.

Role of the NAIC and Federal Government

There is no clear consensus among the property/casualty industry on the appropriateness of a federal supervisory or management role in insurance regulation. While a significant segment of the industry supports the adoption of an optional federal charter approach to regulatory modernization, the majority of main street insurers are reluctant to cede any form of regulatory authority to the federal government or to a non-governmental institution such as the National Association of Insurance Commissioners (NAIC). However, all agree on one thing and this is that the greatest threat to efficient markets is dual or multiple layers of regulation. Creating new oversight institutions or layers of reporting will drive up the cost of insurance products, make it harder for smaller companies to compete and ultimately reduce consumer choice. As a result, attempts to unnecessarily expand the regulatory or oversight role of the NAIC or to create a new and duplicative layer of quasi-regulatory authority at the federal level are almost certain to introduce needless controversy into any reform measure.

Conclusion

PCI is pleased that Chairman Baker and the subcommittee have taken an active interest in pursuing targeted state insurance regulatory reforms. We share the goals of the committee of developing a more competitive marketplace, providing better availability of insurance and expanding coverage capacity for consumers.

While PCI supports the general reform concepts, the specific details of the final proposal will be determinative of the level of support of PCI member companies. On behalf of our

over 1000 members, we look forward to working with the committee to modernize and improve the state insurance regulatory system.

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