S. HRG. 108–900

# EXAMINATION AND OVERSIGHT OF THE CONDITION AND REGULATION OF THE INSURANCE INDUSTRY

## HEARING

BEFORE THE

## COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

THE CONDITION AND REGULATION OF THE INSURANCE INDUSTRY

SEPTEMBER 22, 2004

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# C O N T E N T S

## WEDNESDAY, SEPTEMBER 22, 2004



## WITNESSES



### Additional Material Supplied for the Record

# EXAMINATION AND OVERSIGHT OF THE CONDITION AND REGULATION OF THE INSURANCE INDUSTRY

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**WEDNESDAY, SEPTEMBER 22, 2004**

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, DC.*

The Committee met at 2:05 p.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

### OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

I want to first thank our witnesses for appearing here this afternoon. It looks like we have a full house, not just at the witness table, but in the room.

This hearing is an outgrowth from an earlier hearing in which we examined conditions in the financial services sector 5 years after the passage of the Gramm-Leach-Bliley Act.

After hearing some of the witnesses touch on insurance-related issues, I came to the conclusion that it would be important for this Committee to dedicate additional time to focus specifically on these matters—thus, today's hearing.

Based solely on its size and scope, the insurance industry is of considerable importance to our economy. It employs millions of people, safeguards the lives and property of hundreds of millions of Americans, and holds trillions of dollars in assets. Additionally, as stewards of substantial amounts of premium dollars, insurance companies play a key role as investors in our capital and real estate markets.

With insurance playing such a meaningful role for consumers and the economy, I think it is our responsibility to consider some basic questions about the industry. For instance: Is it financially sound and able to meet its responsibilities, that is, the industry? What is the nature of the prevailing business and operational conditions? Finally, what challenges will the industry face as it moves into the future?

As I noted previously, insurance is a very important industry. Because of its importance to the economy, it has long been subject to an intricate regulatory scheme. I look forward to beginning a thorough review of it with our witnesses this afternoon.

As an aside, I want to mention that Senator Sarbanes and I are sending a letter to the General Accountability Office requesting an examination of the troubling reports that military personnel were sold insurance and mutual funds that appear to have excessive premiums coupled with minimal benefits.

Clearly, we all owe our fighting forces a debt of gratitude and respect. It is incumbent upon us here to make sure that military personnel receive financial services of the highest quality, services that will truly meet their needs and the needs of their loved ones. And we look forward to the GAO's report in the future.

I also want to note that Senator Johnson, who is here with us, has been very active in this area, and I wanted to commend this, something you might want to touch on, too, at the right time.

Senator Johnson, I will recognize you.

## STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman, and Ranking Member Sarbanes as well, for your role in holding today's hearing on the regulation of insurance. Insurance plays an absolutely critical role in our lives, a fact we do not always appreciate until it is too late, as residents of Florida and the Gulf States or victims or survivors of September 11 or farmers suffering from drought in South Dakota know all too well.

Chairman SHELBY. And Alabama, too.

Senator JOHNSON. And Alabama as well. In fact, particularly in Alabama. Americans need to have access to affordable, reliable insurance policies, and historically, unlike banking, insurance has been regulated at the State level. I appreciate the opportunity to hear today's testimony that will shed light on how that regulatory structure is working and whether any changes are needed.

Of particular concern to me, as Senator Shelby has alluded to, are recent reports that men and women on our military bases have been deceived and misled into purchasing unsuitable insurance products. In these instances, not even the States have been able to regulate or enforce against coercive selling practices, and it has been reported by DoD, which apparently has jurisdiction, has not adequately protected our soldiers.

According to news accounts, recruits are often invited to "personal finance classes," where they are misled into purchasing life insurance policies with high premiums and low returns. Most of these investment products are no longer available in the private market, and we should ensure that new recruits and active-duty personnel are not a captive audience for the sale of such financial products.

While I would hope that such practices are not widespread but, rather, the work of a small handful of bad-faith actors, three Pentagon studies conducted on this issue over the past 10 years revealed instances of this practice at each of the 11 military bases investigated. Furthermore, despite these findings, such sales abuses have been allowed to continue to the personal detriment, both financial and emotional, of the men and women and their families in the armed forces.

Clearly, we need to improve the regulatory supervision of insurance sales in the military market if only to clarify the complex jurisdictional issues governing their regulation.

Last week, I wrote this Committee to encourage the oversight needed to improve our current regulatory framework, and I greatly appreciate today's hearing since it is an opportunity to discuss this issue in the context of some of today's broader questions about the regulation of insurance products.

Unfortunately, I will be unable to stay for the entire hearing, but I will be examining the record from today's hearing with great interest. And I would appreciate it if relevant witnesses would be willing to address this issue.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sununu.

**STATEMENT OF SENATOR JOHN E. SUNUNU**

Senator SUNUNU. Thank you very much, Mr. Chairman. I appreciate you holding this hearing and to a certain extent appreciate the degree to which you have tolerated my nagging questions about this issue, broadly speaking.

Chairman SHELBY. I did not think they were nagging. I thought they were probing.

[Laughter.]

Senator SUNUNU. Thank you very much. I hope my mother is watching.

This is an important issue, and it is very nice to see the degree to which we have been able to pull together so many stakeholders, people with different ideas and interests in the insurance industry, broadly speaking, and in any legislative remedy that we might seek, because that is truly the only way to arrive at some consensus about how we might approach this problem. The industry is very complex, and it is also, as a result of the State regulatory structure that has been described, somewhat fragmented. Some States have recognized this problem and have worked to establish either standards or to reform or deregulate certain lines; others have not. And as a result, we have a number of different playing fields all across the country, and this fragmentation does cause problems. Fragmentation discourages innovation. Fragmentation ends up costing consumers more when they go to buy a product, costs businesses more when they go to buy an insurance product. And fragmentation limits competitiveness, I think both domestically and in the international markets. And more and more we are seeing the insurance industry, like any other industry, is a global market, and we certainly do not want to encourage a fragmented regulatory environment that results in U.S. firms being somehow disadvantaged in that competitive market.

I think this is the beginning of a significant, I hope not too long a process, but it is a very important process. We know that the House has already begun down this road, has had hearings, and there has been some discussion about legislation to create standards, to reform the regulatory environment, and as a result, to deal with the fragmentation of which I spoke. I look forward to this hearing. I do not know exactly what the right remedy is, but I know we need to strike a balance. At the same time, I think that if we can head toward a system that is more standardized, that is a little less heavy-handed than some of the harsh price and form regulations that we see in the industry right now, consumers will be better served, markets will be more competitive, and our industry will be more competitive overseas.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Dole.

**STATEMENT OF SENATOR ELIZABETH DOLE**

Senator DOLE. Thank you, Chairman Shelby.

In 1871, the National Association of Insurance Commissioners held its first meeting. At the end of the meeting, founding member and New York Insurance Commission George W. Miller said: "The Commissioners are now fully prepared to go before their various legislative committees with recommendations for a system of insurance law which will be the same in all States, not reciprocal but identical, not retaliatory, but uniform."

I wholeheartedly agree with Mr. Miller's clear desire for a uniform insurance regulatory system and only wish the NAIC had been more effective in realizing its goal. In today's economy, it seems remarkably inefficient to require an insurance company or insurance agent to comply with 50 different standards of business from 50 different regulators. Indeed, at this time of increasing global competition, it is hard to lecture to our trading partners about opening markets when we still have these kinds of barriers to interstate domestic commerce. By breaking down the current State barrier, insurance providers and producers will be able to offer consumers more choices at a lower cost.

The insurance business of the 21st century spans State and national borders with an increasing emphasis on national insurance programs, multi-State clients, and cutting-edge technology. However today's agent licensing and new product approval for companies are based on yesterday's market, one in which insurance companies, agents, and their clients did business solely in their own region.

While all of this may sound like strong opposition to the current system, this is not the case. I believe that today's State regulatory system works well for the insurance industry, and replacement with a system of Federal oversight is simply unjustified at this time. However, I do believe Congress has an important legislative role to play. As we are all aware, almost 5 years ago Congress approved, and the President, signed financial services modernization legislation, entitled the Gramm-Leach-Bliley Act. One of the provisions within this bill, entitled the National Association of Registered Agents and Brokers, created a literal "Sword of Damocles." This condition threatened to create a national license for insurance agents if a majority of States did not pass laws that allowed for reciprocal licensing.

Motivated by this incentive, States acted quickly. As of last month, 41 States have been certified by the NAIC as meeting the requirements of the Gramm-Leach-Bliley Act. It is my hope that Congress will take the next step in this effort and consider legislation to give States the incentive to adopt a uniform model of insurance regulation.

This is a long-term goal. I hope we can all work toward this. Until that time, I believe there is yet another issue Congress should consider. I would hope we could agree to extend the Terrorism Risk Insurance Act, TRIA. On July 22, Senators Dodd, Bennett, Schumer, Hagel, Reed of Rhode Island, Bunning, Carper, Crapo, Chafee, and I introduced the Terrorism Risk Insurance Extension Act. I have heard from countless groups and individuals in North Carolina who are very concerned about what will happen when TRIA expires next year. I share their concerns, and I am committed to working to ensure passage of our bill as soon as possible.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Corzine.

**STATEMENT OF SENATOR JON S. CORZINE**

Senator CORZINE. Thank you, Mr. Chairman, and I appreciate very much your holding this hearing. The oversight and state of regulation of the American insurance industry is an absolutely essential topic for consideration, and I think personally for modernization, which I will come back to in a second. But I would like to go off the clock because we have two New Jersey luminaries on the panel, people that I have great respect for, and I have to say that Art Ryan, the Chairman and Chief Executive Officer of Prudential, I consider a very good and close personal friend. He leads one of the great companies certainly in New Jersey, and I think in our Nation, and I certainly respect the leadership he has shown in the business community in general and in our local community in specific about setting high standards of conduct and also with regard to giving back to the community.

I also would point out that recently he had the responsibility of leading his people through the events that deal with terrorism as the headquarters building in Newark was one of those identified, and the care and quality of leadership he showed to his people and the stability he brought I thought was extraordinary.

I want to welcome Mr. Ahart, who is also from New Jersey, and has played a leading role in Insurance Agents and Brokers of America. He has been also a very tireless leader in our community, and I am pleased to have him join us and speak on his views.

Back to the subject at hand, let me just say that the importance of insurance to our society and our Nation goes without saying, and I think all of us want to make sure that we have the most efficiently running markets as possible. I know the modernization acts that we have taken in other industries, other aspects of the financial securities industry, I think have been positive additions leading to positive allocation of capital and work. And I am one that believes Congress should consider a fundamental regulatory form that would establish an optional Federal charter system for insurance industry regulation similar to the current structure for banks financial markets are national markets. In fact, they are international markets. And I think consideration of this and implementation of those programs would lead to lower-cost insurance products on the whole, greater speed-to-market, simpler compliance costs, and other elements across the industry. I know this is one of those hearings that starts that discussion and overview, and I am pleased to take part in it.

I also want to reinforce what I heard from Senator Dole. I believe we should work very expeditiously to deal with the terrorism risk insurance legislation. It is essential. I heard about it regularly from a whole broad cross-section of the community. As you know, we sent a letter yesterday with Senator Dodd and other Senators. We are all prepared to work in a bipartisan manner. I think this is an essential element that we should deal with.

Again, I want to thank you, Mr. Chairman, as always presenting a thoughtful approach to how we look at these thorny issues.

Chairman SHELBY. Thank you.

Senator Crapo.

**STATEMENT OF SENATOR MIKE CRAPO**

Senator CRAPO. Thank you very much, Mr. Chairman. The issues I think have been pretty well-framed here. Clearly, I do not think there is much disagreement with the fact that the insurance regulation system in our Nation needs to be updated and modernized, and we need to find some solutions to the issues that we face. Issues of the inefficiencies of fragmentation and the barriers to markets that have been already discussed are issues that we are all very concerned with. At the same time, many of us are very concerned about remembering that this is a Federal Government and that we recognize States' rights and the importance of dealing with these issues in a way that preserves the sovereignty of the States to the maximum extent possible.

I am going to be very interested in the discussion of the testimony that is presented today on these issues. The bottom line is I believe there is a way we can find answers, achieve the updating and the modernization, and develop really positive, forward-looking solutions. But we are going to need to put our minds together and find those solutions, and that is what I look to hear from the panel here.

I also want to join with Senator Dole and Senator Corzine in adding my encouragement to taking up expeditious handling of the TRIA legislation. I think that is very important for us to do, and that is one of the reasons I am a cosponsor of that legislation.

I look forward to the testimony of the witnesses. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Dodd.

**STATEMENT OF SENATOR CHRISTOPHER J. DODD**

Senator DODD. Thank you, Mr. Chairman. And as Mo Udall used to say, "Everything has been said but not everyone has said it."

[Laughter.]

I will add a few more words here.

First of all, let me thank you, Mr. Chairman, and Senator Sarbanes for holding this hearing. It is a timely hearing to have, and I want to welcome our panel of witnesses here, all very distinguished representatives of the important insurance industry. And like my friend and colleague from New Jersey, I want to welcome my collegiate friend, Art Ryan, whom I have known for many years and have great respect for. He has been a great pal, and I listen to him a lot when he talks about this industry and the importance of it.

Senator Shelby, I know in particular you and other of our colleagues who represent some of the Gulf States and the shoreline particularly in the South have been devastated over these last number of weeks, and obviously those are questions that we will want to raise today with our panel here because so many lives have been so terribly disrupted by the natural disasters that have ripped the Gulf State area and the eastern coastal areas of our country. Literally, people's lives have been swept away and changed so quickly and so dramatically by these events, and obviously this will impact the insurance industry as well. So that is an important issue.

Insurance is a very important issue and a very important part of our Nation's economy. In the past 10 years, employment in the insurance industry has averaged about 2.1 percent of total U.S. employment; 1 out of every 50 jobs in the United States is insurance related. That ratio, I might point out, having looked over this room, is probably a bit lower than the ratio of insurance-related jobs that are in the Committee hearing room today.

But, at any rate, it is something—we tend to think of insurance only when disasters occur, things go wrong, but obviously it is critical—I think it is obvious it is a critical component to our overall health as an economy. By protecting people, property, goods, services, every sector of America's $11 trillion economy is related to the stability that the insurance industry provides. And, again, the panel knows this and I think most of my colleagues do as well, and that is why I think the importance of reviewing in this hearing the condition of the insurance regulation is an important one. And I look forward as well to hearing from our witnesses in that regard.

I would be remiss—and, again, I appreciate my colleagues, as I heard them, Senator Dole, Senator Corzine, and Senator Crapo, talk about the TRIA legislation. I know it expires more than year from now, in December 2005, and so there is a sense, I know, on the part of some that we have time on this issue. But starting in less than 3 months, policyholders will be unable to enter into standard 1-year contracts that have the full benefit of the Federal backstop that the Terrorism Risk Insurance Program has provided.

While it is true we have more than a year before the law expires, we only have about 12 weeks, if you will, before it really becomes important for industries and businesses out there that this issue is so important to.

The uncertainty will have an impact on tens of thousands of companies, literally, large and small across the country, who will be forced to ensure the prospect of a terrorist attack without critically important insurance coverage. Business needs certainty, and the failure to extend TRIA will place tremendous uncertainty in the business community. This is not a partisan issue, as my colleagues have pointed out. The legislation that I have introduced with Senator Bennett, Senator Schumer—20 of us all together, 10 Democrats, 10 Republicans, have signed on to this bill for an additional 2 years.

A recent study, Mr. Chairman, conducted by Glenn Hubbard, former Chairman of the Council of Economic Advisers, strongly supports the extension of TRIA. I suppose there could not be any clearer test of the bipartisan nature of this bill than having me quote Dr. Hubbard, I suppose.

[Laughter.]

It will give you some idea of where we are in all of this.

Anyway, he states that if TRIA is allowed to expire, the GDP may be $53 billion lower and roughly 326,000 fewer jobs may be created. And this is without any additional terrorist attacks in the country. I know there is some reticence to take this up soon, that we only have a few days left here, but we continue to urge, sooner rather than later, consideration of this legislation given the implications and, as I say, the certainty or uncertainty that can exist if we do not act on this.

Again, I thank you for listening, Mr. Chairman, and I look forward to hearing from the witnesses.

Chairman SHELBY. Thank you.

We have a distinguished panel, as everyone has noted here today. I just want to introduce the panel.

Oh, we have Senator Hagel.

## STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Well, actually we do have a former Nebraskan on the panel, as you know. I welcome Mr. McCartney, who was our Insurance Commissioner.

Chairman SHELBY. I apologize, Senator.

Senator HAGEL. I have no statement, so I really, as usual, have nothing to say.

[Laughter.]

But just to say that we do appreciate all this fire power.

Senator DODD. But you are going to say it, anyway.

Chairman SHELBY. Omaha has no insurance, is that what you are saying?

[Laughter.]

Senator DODD. Mo Udall was really——

Senator HAGEL. We have a little insurance in Nebraska. Dodd, you had your time. Don't trespass over here.

[Laughter.]

Although I will say that I very strongly support the comments of Senator Dodd and others who have talked about TRIA, and the Chairman and I have talked about that as well, and I know the Chairman is paying attention to it because it is critically important for all the reasons you gentlemen understand. And Senator Dodd made the point, I think, very well as most of us understand.

So, I would add my thanks, Mr. Chairman, for your focus on this issue and bringing together the kind of intellectual insurance fire power that you have here today. So thank you. I look forward to hearing the witnesses.

Chairman SHELBY. Thank you, Senator Hagel.

Our distinguished panel: Gregory Serio, Superintendent, New York Department of Insurance; Arthur F. Ryan, Chairman and CEO, Prudential Financial; William H. McCartney, Senior Vice President, USAA; Robert Hunter, Director of Insurance, Consumer Federation of America—no stranger up here; Alan Liebowitz, President, OMNIA Life, Limited; Thomas B. Ahart, President, Ahart, Frinzi & Smith Insurance; Albert Counselman, President and CEO, RCM&D, Inc.; and Brian Atchinson, Executive Director, Insurance Marketplace Standards Association.

I welcome all of you, gentlemen. All of your written testimony will be made part of this Banking hearing record in its entirety, and if you would basically sum up your top points. We will start with you, Mr. Serio.

**STATEMENT OF GREGORY SERIO**
**CHAIR, GOVERNMENT AFFAIRS TASK FORCE**
**NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS**
**AND**
**SUPERINTENDENT, NEW YORK DEPARTMENT OF INSURANCE**

Mr. SERIO. Thank you, Senator, and good afternoon.

Mr. Chairman, thank you for offering us the opportunity to speak about insurance regulation in the United States today. As you said, my name is Greg Serio. I am not only the Superintendent of Insurance for New York, but I also represent my colleagues from the States, the District of Columbia, and the Territories, comprising the National Association of Insurance Commissioners. And, Senator Dole, I can tell you that the words of my predecessor, Superintendent Miller, back in 1871 go with me every day. If I can be one of the Superintendents that gets it right, I think that would be a good thing.

The power of the hurricanes that recently ravages parts of your home State, Mr. Chair, as well as others on the Gulf Coast and throughout the eastern United States, as powerful as they were, they were no match for the power of the insurance regulatory system and insurers themselves to respond to those disasters, bringing immediate and meaningful, financial relief, to millions who experienced unprecedented losses from an unrelenting hurricane season. The level of interstate cooperation has been significant and meaningful, bringing the two critical components of State insurance regulation—consumer protection and financial solvency protection—to bear for the benefit of all insurance consumers who were affected by those storms.

While hurricanes and other major disasters bring to light, at least over the course of a few days, the true value of the State-based regulatory system, its benefits are reaffirmed daily. Pushing for greater uniformity and reciprocity in laws and processes when necessary and appropriate, while retaining the distinctly local flavor of insurance regulatory oversight, insurance commissioners have responded to the challenge of modernizing the system of State-based regulation without compromising its most important attributes in the NAIC's "Statement of Intent: The Future of Insurance Regulation" in 2000. That has been followed up by an aggressive and largely successful program of regulatory modernization, highlighted by new uniform standards and agent and broker licensing, new methods of financial surveillance that focus on risk-based analysis, additional freedoms in product form and rate approval processes throughout the States, and an unprecedented leveraging of technology to the benefits of insurers, agents, and consumers alike.

Before the end of this year, Mr. Chairman, your home State regulator, Commissioner Walter Bell, will deliver the first national standards for life insurance products, which, when coupled with the NAIC's tireless pursuit of its Interstate Compact for Insurance

Regulation Initiative will be the foundation upon which insurance regulation is based for the 21st century.

The speed of reform and innovation is unprecedented, but largely unheralded. For some, it is a dogged determination for the pursuit of Federal charters on the false hope that OFC's are quick fixes to the problem as they see them. Rare is the industry commentary, or the consumer commentary, for that matter, that the efforts made to date have fundamentally improved the State-based regulatory system in our responsiveness to all of our constituencies. From our vantage point, though, they have improved, and they have improved notably. Where industry, consumers, and regulators have sat down at the same table with the same objective of improving State-based regulation, great things have, in fact, been accomplished.

As the NAIC continues to travel down its own road map to insurance regulatory modernization, which we have shared with both the Senate and the House, the insurance industry, life and property companies both, can greatly contribute to the improvement of insurance regulation by doing the following three things:

First, join within insurance regulators in the State capitals to push for passage of the NAIC's Interstate Compact legislation. Endorsed by the major State legislative groups focusing on insurance, this legislation is crucial for giving the industry what it desires most: Uniformity of standards across State lines.

Second, use the improved system for product and rate approvals that have been put in place by the NAIC and individual State insurance departments around the country. While the NAIC has seen an increased use of its State-based electronic rate and form filing process, SERF has not been measurably embraced by the industry as its single best electronic portal for making multi-State form and rate filings. Other speed-to-market initiatives also need greater buy-in by the industry.

And, third, committing to a meaningful program of self-regulation, Federal regulation has not been the missing link in the efforts to modernize insurance regulation; rather, it is the absence of an industry-wide, self-regulating mechanism promoting the highest and best standards on corporate governance, market conduct, and financial safety and soundness. This is what represents the significant hole in the insurance regulatory construct at this time.

Meaningful and effective self-policing, closely tied to and measured against the regulatory system that we have in the United States, will go a long way toward improving uniformity and improving the relations between regulators and the regulated. And I will note that with the presence of the Insurance Marketplace Standards Association on this panel today and its President, Brian Atchinson, who is a former regulator from Maine, I can tell you that there are systems in place already to make that happen. And greater buy-in by the industry will go a long way toward improving the process.

Finally, as has been said by a number of the members of the panel today, there is nothing more important that the Senate together with the House can do for us at this time than extending the Terrorism Risk Insurance Act. Both as a State Superintendent of Insurance and as the representative of the NAIC, nothing more important could be done to help stabilize the economy, as Senator Dodd noted, more than by assuring stability in the delivery of insurance products over the course of the next 2 years. And I will just simply add one clarification to what Senator Dodd noted, and that is that the time is now because the renewal process for a lot of policies starts next week. And so getting those renewals with the clarification that TRIA will be extended will go a long way toward extending the stability that we received from the TRIA. But I think really time is of the essence in terms of promoting and moving TRIA along.

Thank you, Mr. Chairman, and we look forward to further dialogue.

Chairman SHELBY. Thank you.

Mr. Ryan.

**STATEMENT OF ARTHUR F. RYAN
CHAIRMAN, AMERICAN COUNCIL OF LIFE INSURERS
AND CHAIRMAN AND CEO, PRUDENTIAL FINANCIAL**

Mr. RYAN. Thank you and good afternoon, Chairman Shelby, Senator Sarbanes, and Members of the Committee. It is an honor to be here today to represent the over 1 million individuals who work in the life insurance industry in America. I am here today not only as the Chairman and Chief Executive Officer of Prudential Financial, but also as the Chairman of the ACLI, which is the American Council of Life Insurers. With 368 members, the ACLI is the principal trade association representing domestic life insurance companies.

I would like to briefly talk about three things: First, the function of life insurers in the marketplace and the economy; second, our role in retirement security; and, third, why regulatory changes are important to the life insurance industry and what ACLI has done and is doing to identify areas that are in need of improvement.

Today, the life insurance industry competes in a national as well as global marketplace. We have entered the 21st century as a much more involved, dynamic partner with American consumers and businesses. We provide financial security for Americans in all stages of life, with products like life insurance, annuities, disability insurance, and long-term care insurance.

These products not only protect a family's finances, but also enable Americans to save money, to accumulate wealth, and, importantly, convert it into a lifetime stream of guaranteed income. No other financial intermediary is able to do that.

Currently, there are over 395 million life insurance policies in force, providing Americans with $17 trillion in financial protection. In addition, Americans have saved close to $2 trillion toward their retirement by investing through annuity products. Our long-term commitments and investments have placed us as one of the largest investors in the United States. The industry has invested approximately $3.4 trillion in the financial markets. Fifty-seven percent of the industry's assets are invested in long-term assets—mortgages, real estate, bonds, and the like.

That is only part of the story. The other part is, notwithstanding the massive investment we make in the economy, it is the area of long-term savings and retirement security where we can probably make the greatest impact. With 76 million baby boomers nearing retirement, we clearly face a retirement crisis. We must confront the fact that the average American nearing retirement has $47,000 in savings and assets, not include his primary real estate. Industry research indicates that 68 percent of Americans believe they will not be able to save enough for retirement.

Future retirees will have fewer sources of guaranteed income. This is due to the decline of traditional defined benefit plans and the fact that Social Security, on average, replaces about 40 percent of earnings. If nothing is done, a real possibility of retirement crisis is before us.

Our industry is dedicated to supporting individuals to help them retire. We continue to be a prominent resource in helping both large and small employers provide qualified retirement plans.

The industry also enables individuals to take control of their own long-term savings through the purchase of annuities. No single saving vehicle is going to solve this problem, but our industry is positioned to offer your constituents, and all Americans, an array of product choices to meet their retirement needs.

However, for the insurance business to remain viable and serve the needs of the American public effectively, our system of life insurance regulation must become far more efficient and responsive to the needs and circumstances of a 21st century global business.

Today, life insurers operate under a patchwork system of State laws and regulations that lack uniformity and is applied and interpreted differently from State to State. The result is a system that is characterized by delays and unnecessary expenses that hinder companies and disadvantage their customers. We believe it is appropriate, and we are asking for your help, to modernize our regulatory structure to ensure we are able to continue to serve our customers in the most efficient and effective way.

To achieve that, the ACLI has been addressing regulatory reform on two tracks. Under the first track, the ACLI is working with the States to improve the State-based system of insurance regulation. Under the second, the ACLI is beginning to work with Congress toward a federally oriented solution, which we believe can ultimately best be achieved through an optional Federal charter.

Mr. Chairman, the ACLI is ready to work with this Committee to put in place an appropriate Federal regulatory option available to insurance companies, agencies, and producers. It is in the best interests of our industry, your constituents, and our overall economy to do so as quickly as possible. With your help the life insurance industry will be able to help American families and businesses meet their financial needs today and beyond.

On behalf of the member companies of ACLI, I would like to conclude by thanking you and the Members of the Committee for the opportunity to express our views on this most important subject. Thank you.

Chairman SHELBY. Mr. McCartney.

**STATEMENT OF WILLIAM H. McCARTNEY**
**SENIOR VICE PRESIDENT, GOVERNMENT AND INDUSTRY RELATIONS, USAA GROUP**
**ON BEHALF OF THE**
**AMERICAN INSURANCE ASSOCIATION**

Mr. MCCARTNEY. Mr. Chairman, Senator Sarbanes, Members of the Committee, my name is Bill McCartney. I am Senior Vice President, Government and Industry Affairs, of the United Services Automobile Association in San Antonio. USAA is a member of the American Insurance Association, and I am testifying on behalf of USAA and the other 450 members of that association. USAA and its 22,000 employees provide insurance, banking, and investment products to more than 5 million current and former members of the U.S. military and their families. It is one of only three property and casualty companies in the country that holds the highest ratings from all three nationally recognized statistical rating organizations.

It is the firm belief of USAA and AIA's other member companies that today's State-based regulatory system does not allow the insurance needs of Americans or the businesses they run to be efficiently and effectively met. In fact, many States have hit the trifecta of regulatory failure that is the focus of my testimony today: Lack of regulatory uniformity, pervasive Government price controls, and entrenched Government product controls.

I speak from "inside" experience. Before joining USAA, I served as Nebraska's Director of Insurance for 7 years, as well as President of the National Association of Insurance Commissioners. I have been involved in years of State-based efforts to bring more uniformity and efficiency to the current system, and I only grow more convinced of the urgent need for Federal action.

The mere existence of different State systems is a significant obstacle for USAA and any other insurer attempting to serve a national and highly mobile population. A limited survey by AIA of State insurance filing requirements around the country found approximately 350 that dictate how rates are to be filed and reviewed and approximately 200 that relates to the filing and review of new products. It is impossible to believe that dealing with more than 500 separate filing and review requirements could ever equate to efficiency and consistency.

USAA is a member-owned organization. Our policyholders bear every penny we incur responding to these inconsistent regulations. Each departure from uniformity and consistency means higher costs for our members.

USAA has had a long compact with our active-duty members. We will insure their families' special needs wherever they are stationed. As a result, USAA operates in 54 distinct U.S. insurance regulatory environments, leaving us with at least 54 different regulatory structures to navigate.

And unlike other insurers that have the ability to defensively withdraw from a State due to a difficult regulatory environment, USAA's commitment to serve our members wherever they are sent takes away that option from us. The "heavy-handed" regulatory systems in place in all too many States do not mean better consumer protections. They mean limited choices for consumers. The emphasis on price and product controls in these jurisdictions forces USAA to devote enormous resources to respond to "premarket" obstacles rather than developing innovative, new insurance products for our members. The system, in fact, discourages innovation because the timeline for gaining approval of new products is often longer than the shelf life of the innovation.

The rest of the USAA financial services family does not face these regulatory obstacles, and it is confusing and frustrating for our members who often use technology to access our products and services. For example, whenever a member is transferred to another location, a simple change of address made electronically at our website is all that is needed for most of our financial products. But for our property-casualty insurance products, the member's change of address is the beginning of a long process, not the end.

We are not advocating abrogating insurance regulation. There is a vitally important role for regulators: Overseeing companies' solvency. But there have been some recent notable lapses at the State level on that front, and for insurers operating in most or all jurisdictions, even solvency is better overseen at the Federal level to address interstate ownership and transactional matters. So, after much deliberation, USAA and the other AIA members believe that a market-based optional Federal charter would be the best route to true regulatory reform. The optional Federal charter would eliminate the arcane Government price and product controls that have been so corrosive to the State regulatory system. The optional Federal charter also would provide for uniform national oversight of federally licensed insurers.

And, equally important, the optional Federal charter is just that: A choice. Consumers desiring to transact business with a State-regulated insurer would have that option since many insurers would opt for continued State regulation. This is not a new regulatory paradigm but one that is based on the chartering system for U.S. banks.

Our preferred solution also does not place the Federal Government in unfamiliar regulatory territory. There are numerous examples of Federal involvement in property-casualty insurance, and one that immediately jumps to mind is the one that was mentioned earlier—terrorism risk insurance. While the TRIA program expires in 2005, insurers, policyholders, regulators, and even many Members of this Committee are currently calling for a 2-year extension in order to gather all necessary data about the risk, and for stakeholders to jointly develop and implement a long-term public-private solution.

Finally, I would be remiss if I did not applaud the House Financial Services Committee for its unyielding efforts to address the problems I have outlined for the Committee today. Over the past few years, the House has conducted 15 hearings on State insurance regulation in a relentless drive to uncover the ills that plague the State regulatory system. While enactment of the optional Federal charter is our ultimate aim, we support the House process, as well as the market-driven direction of the legislative draft that has been widely circulated. In particular, the draft takes a historic "free market" approach to insurance rates, recognizing the negative legacy of State government price controls. We look forward to continuing to work constructively with both the House and the Senate as well move forward with this important public policy issue.

Thank you, Mr. Chairman, and I welcome an opportunity to respond to questions.

Chairman SHELBY. Mr. Hunter.

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

Mr. HUNTER. Thank you, Mr. Chairman.

Not long ago, we were all startled to find life insurers were still charging blacks in Alabama and other parts of the South more than they were charging whites. State regulation has moved to end that abuse. Years before that, the States had to end the massive market conduct abuse by the largest life insurance companies, companies like Prudential, although it took lawsuits to uncover the abuses in the first instance.

A decade ago, in the wake of a hurricane, those remembering Hurricane Andrew, Allstate threatened to terminate coverage for 300,000 Floridians, but the State stepped in to protect the homeowners until a new system could be created.

Regulators have had to act on redlining and other unfair practices. In Maryland, after determining that credit scoring abused low-income and minority homeowners, the State banned its used. States require auto insurance. Banks require home and other property insurance. To a consumer, insurance is a piece of paper until they test it with a claim. Regulation is necessary to assure that the insured does not become insolvent or just walk away from the insured or low-ball the insured when a claim occurs.

Regulation is needed to make sure that people are not deceived by the fine print of policies or by outright fraud. When you do not regulate, you end up with the military problems that you are addressing.

Insurance is a complex legal document that many consumers do not understand. It is difficult to shop for insurance in that a consumer needs information not only to determine price, but also service quality, solvency, and then they run into underwriting. Insurance pricing is complex, up to 50 tiers for one company for similar applicants. Beyond that, they have thousands of classes, like age, credit history, claim history, and other variables. And insurance companies collude on parts of prices under the antitrust exemption of the McCarran-Ferguson Act.

You cannot rely just on competition to regulate insurance. One hundred and fifty years of State regulation has occurred because of these facts. The people need protection, and that is why democratically elected legislators or the people in direct referenda have acted.

There are genuinely different needs in different States, so California does not use exactly the same method as North Dakota. That makes sense.

I served as Federal Insurance Administrator under President Ford and President Carter and as Texas Insurance Commissioner. I can tell you, both levels of Government can screw it up or can do it well. I have done both.

[Laughter.]

Senator SARBANES. You have done both levels of Government, I take it.

Mr. HUNTER. I have screwed up at both Federal and State levels.

Here is an important thing to remember: Consumers do not care who regulates, but we do care about the quality of regulation. State regulation has many flaws. I have been a very sharp critic. Not the least of it is insurance interests dominate. In recent days, the States and the NAIC have weakened consumer protection, particularly for small businesses, under the threat of Federal moves into their turf. However, despite their failures, State regulations have had some notable successes. Solvency regulation is much stronger and good, and some States, like California in its Proposition 103 regulations, which maximize both competition and regulation, have amazing successes.

The burden of proof must be on those who would ask you to radically change the current system to shift away from these 150 years of State regulation to an unknown, untested Federal approach. They have to prove that this would not harm consumers.

Insurers have been opportunistic in their willingness to call for Federal control. They have done it before when they thought the Federal Government was more laissez-faire than the States. They did it in the 1800's in the *Paul* v. *Virginia* case. Until very recently, they steadfastly maintained that their allegiance to State regulation was forever, and now they have changed because they sensed Federal regulation might be weaker. They have worked to pressure States to weaken consumer protections with the lure that they might be able to keep the insurers in their camp in the upcoming turf battle.

The cure that the insurers propose is far worse than the disease they complain about. Consumers agree with reducing regulatory inefficiency. We pay for regulatory inefficiency. But the insurer proposals of speed-to-market for lousy products is a lousy idea. Front-end control is in place because it makes no sense to allow bad products to come into the market when consumers are not capable of sorting out fine-print differences in complex legal documents. Insurers propose uniformity, and consumer do not mind uniformity. We can be for that. But they propose the weakest standards in any State as the point to achieve uniformity. For them, consumer protection is not even an afterthought. They propose setting up regulatory competition between the States and the Federal Government to create a race to the bottom in regulation that consumers must oppose with all the strength we can muster.

They even proposed in the SMART Act deregulating cartel organizations and leaving the antitrust exemptions of McCarran intact. We suggest that if uniformity is the goal, why not the best? Why not adopt something like the California system? If competition is really the goal, why not get rid of the antitrust exemption? Why do they desire a continuation of a ban on FTC involvement in consumer protection if consumer protection is their interest? Why are they against the CRA if they want to have a bank-like system?

Consumers know that Federal regulation could be more uniform, better funded, and have strong protections. State regulation has advantages. It exists, and many successes to point to.

We list in my testimony our principles for how we will judge any bills that come forward, and so I would encourage you to look at that. There are ways to achieve uniformity without gutting consumer protections. The Committee should review these.

I really need to mention TRIA. Here is a classic bait-and-switch tactic. The insurers agree to Section 108 of the bill that you passed that required Treasury to report to Congress by June 30, 2005 regarding key questions such as: Is the program needed after December 2005? Should the program be in its same format, or should it be changed to require premiums to be paid to protect the taxpayers? And so forth.

Now they say do not wait, as if they did not know they had annual policies when they agreed to the studies 3 or 4 years ago. There is no rush, Mr. Chairman. There is no rush. The insurers have endorsements approved in almost all States that allow them to end coverage for terrorism on January 1, 2006, if TRIA is not extended, on those policies. So there is no rush. The Treasury Department can complete its study and report to you by next June, and you can act accordingly with facts in hand. To act now will unnecessarily put taxpayers at risk when the private sector can handle most, if not all, of the terrorism risk in America. Remember, the Athens Olympics got coverage privately with no Government backup.

Thank you, Mr. Chairman.

Chairman SHELBY. At this point, before I go to the next panelists, Senator Hagel has to go to another Committee, so I want to recognize him.

## STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Senator Allard, Mr. Chairman. I just want to briefly put my opening statement in the record.

Chairman SHELBY. Pardon me, I named you "Hagel."

[Laughter.]

Hagel was here earlier. Go ahead.

Senator ALLARD. I would like to put an opening statement in the record, and I apologize to the panel for this brief interruption.

Thank you, Mr. Chairman.

Chairman SHELBY. Without objection, it is so ordered.

Mr. Liebowitz.

Senator SARBANES. Hagel is rushing back to the hearing to correct this situation.

Chairman SHELBY. He is. He is looking after Omaha.

Go ahead.

## STATEMENT OF ALAN F. LIEBOWITZ
## PRESIDENT, OMNIA (BERMUDA) LTD.
## ON BEHALF OF THE
## AMERICAN BANKERS INSURANCE ASSOCIATION

Mr. LIEBOWITZ. Thank you, Mr. Chairman. My name is Alan Liebowitz. I am President of OMNIA (Bermuda) Limited, an insurance affiliate of the Old Mutual Financial Network, and I appreciate the opportunity to testify before you.

I am here on behalf of the American Bankers Insurance Association, which is a subsidiary of the American Bankers Association.

I suspect this Committee might be somewhat surprised at what might be a first, which is to see bankers and insurance companies sitting elbow to elbow and on the same side for once. And we all agree on one thing: That the current insurance regulatory system is broken.

As you have heard from the insurance perspective, here from the banking perspective, it is impossible for bankers to do business in all 50 States, to offer insurance products to their customers on a uniform basis when the insurance business itself is subject to 50 different sets of rules enforced by 50 different regulatory bosses.

The effect of this regulatory morass on the bank/insurance business is staggering. Some examples have already been touched upon by preceding witnesses. There is continued disharmony among the State producer licensing laws, despite Congressional efforts to eliminate them. Despite Gramm-Leach-Bliley, many States continue to impose different and more burdensome rules on insurance sales by bank-affiliated agents than those imposed on independent agents.

Gramm-Leach-Bliley also included provisions to promote uniform producer licensing laws and regulations. These provisions have been something of a hollow victory. Instead of a nationwide system of uniform standards, we now have reciprocal licensing laws in about 40 States that continue to differ from State to State. In addition, because the threshold was met, some of the largest States, like California, have been able to avoid reciprocal licensing laws altogether.

Another problem with State insurance regulation which you have heard about is price controls. Federal price controls on banking products were eliminated over 20 years ago. Congress realized that such artificial market constraints do more harm than good. However, the insurance industry continues to be subject to extensive price regulation to the disadvantage of consumers. The consumer benefits associated with competitive rates are more than just speculative. Several States, such as Illinois, have moved away from rate regulation, and in those States, rates have actually fallen on various products.

States' prior approval requirements for insurance forms, that is, the benefits that the company can actually offer, deprive consumers of innovative insurance products and the ability to purchase them in a timely fashion. It can take months, sometimes years, sometimes never, to get the approval from a State insurance regulator to introduce a new product in a particular State. Such delays are inevitable when every State has an opportunity to review and approve products and apply their own parochial views as to what is in the best interest of consumers.

So what do we do about these problems? There is a consensus among the banking and insurance industry, and others, that Congress must step in. The remaining question is how. Together with the ACLI and the AIA, we have developed a proposed model after the dual banking system, which we call the optional Federal charter. Our proposal would establish a Federal insurance regulator to charter and regulate insurance companies and agents. In one motion, this would solve the problem of States' disparate regulatory schemes by enabling some to avoid them altogether. Just like the dual banking system, State insurance regulators will continue to regulate those companies and those agents that wish to remain State-regulated. An alternative Federal regulator would charter and regulate companies and agents that elect and pay for regulation under one set of uniform Federal rules.

Our optional Federal charter proposal is a comprehensive solution to the problems of licensing, solvency, market conduct, and consumer protection requirements. It is a blueprint for modernizing a regulatory system designed more than 150 years ago to manage an industry that at that time did not cross State boundaries. We would like to work with you, Mr. Chairman, and your Committee to enact legislation establishing an optional Federal insurance charter.

On the other side of the Capitol, we are pleased that the House has begun work on its own proposal to address this issue. We also continue to support efforts by State legislators through the National Conference of Insurance Legislators and the NAIC to achieve uniformity and efficiency in regulation.

I thank you for the opportunity to be here today, and I look forward to your questions.

Chairman SHELBY. Thank you.

Mr. Ahart.

**STATEMENT OF THOMAS B. AHART**
**PRESIDENT, AHART, FRINZI & SMITH INSURANCE**
**ON BEHALF OF THE**
**INDEPENDENT INSURANCE AGENTS**
**AND BROKERS OF AMERICA**

Mr. AHART. Thank you, Mr. Chairman. I am President of Ahart, Frinzi & Smith, an independent insurance agency in Phillipsburg, New Jersey, and I am a past President of the Independent Insurance Agents and Brokers of America. I am proud to be here representing the ideas and views of the IIABA today.

The IIABA supports State regulation of insurance, as we have for over 100 years, for all participants and for all activities in the marketplace, and we oppose any form of Federal regulation, optional or otherwise. Yet despite this historic and longstanding support for State regulation, we are not confident that the State system will be able to resolve its problems on its own. That is why we feel that there is a vital legislative role for Congress to play in helping to reform the State regulatory system. However, such an effort need not replace or duplicate at the Federal level what is already in place at the State level. IIABA supports targeted Federal legislation along the lines of the NARAB provisions of the Gramm-Leach-Bliley Act to improve the State-based system.

Most observers agree that State regulation has worked effectively to protect consumers because State officials are positioned to be responsive to the needs of the local marketplace and consumers. Unlike banking and securities, insurance policies are bound to the separate legal systems of each State, and the policies themselves are contracts written and interpreted under the laws of each State. Additionally, the insurance needs of individuals and businesses can vary from region to region, State to State, and even within a State. For example, the insurance needs of consumers along the Gulf

Coast in Alabama can be different from the needs of consumers in the northern part of the State, as evidenced by Hurricane Ivan.

The diversity of underlying State laws and varying consumer needs from one region to another require local officials that are on the beat.

Despite its merits, State insurance regulation is not without its share of problems. It takes too long to get insurance products to market, and there is unnecessary regulatory oversight in licensing.

The speed-to-market issue is the most pressing from both a consumer and an agent/broker perspective because we all want new and innovative products.

There is growing consensus among observers, including State and Federal legislators, regulators, and the insurance marketplace, that insurance regulation needs to be updated and modernized. There is disagreement about the most effective and appropriate way in which to obtain needed reforms. Some support pursuing reforms in the traditional manner, which is to seek legislative and regulatory improvements on an ad hoc basis in the various State capitals. A second approach, pursued by several international and large domestic companies, calls for the unprecedented establishment of full-blown Federal regulation of the insurance industry. This call for an option Federal charter concerns me deeply.

Although the proposed optional Federal charter regulation might correct certain deficiencies, the cost is incredibly high. The new regulator would add to the overall regulatory infrastructure and undermine sound aspects of the current State regulatory regime. The Federal regulatory model proposes to charge a distant and likely highly publicized Federal regulator with implementation and enforcement. IIABA believes that such a distant Federal regulator would be completely unable to respond to local insurance consumer concerns. Additionally, the optional Federal charter proposal would force the State guaranty funds to accept and backstop Federal-chartered insurers. There is nothing optional about that.

This would be an unprecedented intrusion on State solvency regulation. In the end, the State system would be responsible for insolvent insurers, but could not regulate them to keep them from going insolvent.

However, there is a third way to reform the State system that overcomes the inability of the States to pass uniform laws on their own and does not creates a cumbersome Federal bureaucracy. It is the use of targeted Federal legislation to improve the State-based system.

One of the most significant accomplishments of Gramm-Leach-Bliley was the NARAB subtitle, known as the National Association of Registered Agents and Brokers, which launched agent licensing reform that continues today. Prior to GLBA, there was no consistency or reciprocity among the States, but licensing has improved significantly over the last 5 years as a direct result of Congress's decision to address these issues in Gramm-Leach-Bliley.

The Gramm-Leach-Bliley put the ball in the States' court by threatening the creation of a new national NASD-style licensing entity. The creation of NARAB was only averted when a majority of the States and Territories achieved a level of reciprocity within a 3-year period.

The success of NARAB is a perfect example of what the Federal Government and the States can accomplish in partnership and how Congress can assist the States to achieve needed reforms. We now need to get to full reciprocity and the ultimate goal of uniformity.

In conclusion, it is true that many State regulators and legislators, many consumer groups, independent agents and brokers, some life insurance companies, and most property-casualty companies are strongly opposed to an optional Federal charter. In fact, the Property-Casualty Insurance Association of America and the National Association of Mutual Insurance Companies, which represent property-casualty insurers of all sizes, oppose an optional Federal charter.

IIABA believes a NARAB model can serve as a template for further reform of State insurance regulation. Unlike the creation of entirely new regulatory structure, the enactment of targeted Federal legislation along the lines of NARAB to address certain clearly identified problems with State regulation is not a radical concept. The Senate Banking Committee and the House Financial Services Committee have already proven that this approach can work. Leadership of the House Financial Services Committee has recently decided to take the NARAB approach of targeted reform after conducting a 3-year, in-depth review of insurance regulation. We recommend such an approach to the Senate Banking Committee as well, and look forward to working with the Committee.

Thank you very much.

Chairman SHELBY. Mr. Counselman.

**STATEMENT OF ALBERT R. COUNSELMAN, CPCU PAST CHAIRMAN, THE COUNCIL OF INSURANCE AGENTS + BROKERS AND PRESIDENT AND CHIEF EXECUTIVE OFFICER, RIGGS, COUNSELMAN, MICHAELS & DOWNES, INC.**

Mr. COUNSELMAN. Thank you, Mr. Chairman, Senator Sarbanes, and Members of the Committee as well. I am here today as the CEO of RCM&D in Baltimore, which is Maryland's largest insurance brokerage firm, but I am also representing the Council of Insurance Agents & Brokers, of which I am a past Chairman.

But more importantly, I am also chairman of a large metropolitan area hospital, and I think about that and I think about the hurricane exposure in Florida and Alabama because just yesterday I was with the Chairman of the Sacred Heart Hospital in Pensacola, who is experiencing what catastrophe is all about and what it was like to operate a hospital with no power, no water, and no air conditioning, yet stay in business for the benefit of the community. That is what insurance is all about, and that is what I care about and why I appreciate your having us here today.

I think and our association thinks that insurance regulatory reform is critical for the long-term health of the insurance industry in the United States, and it is way overdue. But I must say that a discussion of the condition of the insurance industry must first address the risks that are posed by terrorism and the importance of TRIA. The need for Federal action in the area of terrorism coverage is a clear example of the limits of State regulation. States could not have on their own implemented TRIA, but thanks to the hard work of the Members of this Committee and others, TRIA was adopted and it did provide, and is providing, the necessary backstop which stabilizes insurance markets, has enabled construction in real estate projects to continue and to go forward and to insure critical vulnerable infrastructure including facilities like hospitals of which I speak.

The evidence is mounting that TRIA is effective, and that purchase of terrorism coverage is increasing. Nearly one-half of all insureds are now purchasing terrorism coverage.

A recent study by Marsh found that the largest percentage of insureds buying terrorism insurance are not only in the energy industry, but also media, food and beverage, hospitality, health care, and the real estate industries, where there are high percentages of those purchasing the coverage.

One of the most significant aspects of these findings is that these industries operate all across our country. They are not limited to one or two cities or geographic areas, and their products and services are used by all Americans. It is important to the energy industry, and to all of our infrastructure to maintain the availability of this coverage.

Despite TRIA's success in stabilizing the market, it has become evident that the private marketplace will not be prepared to take on the full risk posed by potentially catastrophic terrorism losses by the time the law expires in a year. This is not a next-year issue, it is a this-year issue, as policies are now being negotiated that will take effect on or after January 1 and may not be able to provide protection that is offered by that backstop.

I am not saying the sky is going to fall on January 2, but there is every indication that market displacement will occur and that consumers will pay the price of that.

While we appreciate Senators Bennett, Dodd, and Dole for their leadership in introducing legislation to extend TRIA for 2 years, it is important that Congress consider more long-lasting solutions and we are grateful for any co-sponsorship or any other additional Members of this Committee to extend the TRIA bill. We urge you to enact this law before you adjourn this year.

On the subject of regulatory reform, the pace of financial services convergence and globalization is far outstripping the pace of individual reform efforts by the States, and demands far more dramatic action than the States alone are able to provide. Even though State regulators have made some strides in simplification and streamlining, largely thanks to the pressure put on them by the enactment of NARAB, there remain glaring regulatory inefficiencies in the State-based system, not only in the area of producer licensing, but also in product approval processes, access to alternative markets, and many other areas.

Because of NARAB, the producer licensing process has definitely improved in the last few years, but we are still required to hold, in my firm's case, over 500 licenses in 50 plus jurisdictions, in addition to satisfying the inconsistent underlying requirements and renewing them annually, many of which requirements have little to do with standards of professionalism.

Another area of needed reform is speed-to-market, and I will give you one quick example. The Council of Insurance Agents and Brokers sponsors a captive insurance company that provides errors and omissions coverage to 65 of our member firms, including my own, and we are located in 35 States.

A couple of years ago, we needed to raise the rates and broaden the coverage form, so we had to refile the form in all of those States, and it took 2 years to get the approvals and the cost of doing that was $200,000. So it was more than was necessary. All the improvements in State insurance regulatory systems have come about largely because of outside pressure, notably from Congress. NAIC is not in a position to force dissenting States to adhere to standards that it sets, and it is important that Congress provide the leadership and the impetus for the NAIC to act.

The Oxley-Baker proposal is a comprehensive plan addressing multiple insurance regulatory issues including producer licensing, which is a specific concern to my firm and to the Council, and we urge the support of NARAB provisions and uniformity that is included in the Oxley-Baker proposal, and urge you to take action on that bill similar to what we expect the House to do, early next year.

Thank you.

Chairman SHELBY. Mr. Atchinson.

**STATEMENT OF BRIAN K. ATCHINSON EXECUTIVE DIRECTOR, INSURANCE MARKETPLACE STANDARDS ASSOCIATION**

Mr. ATCHINSON. Good afternoon, Chairman Shelby and Members of the Committee. Thank you for the opportunity to speak with you today. I am Brian Atchinson, Executive Director of the Insurance Marketplace Standards Association. We are an independent non-profit organization created in 1996 to promote ethical business practices and strengthen consumer trust and confidence in the marketplace for individually sold life insurance, annuities, and long-term care insurance products.

IMSA-qualified member companies comprise more than 160 of the Nation's top companies, representing nearly 60 percent of the individual premium written in the United States. To obtain IMSA qualification, a company must establish and maintain an infrastructure of policies, procedures, and personnel and demonstrate its commitment to high ethical standards by undergoing a rigorous, independent assessment to determine the company's compliance with IMSA's Principals and Code of Ethical Market Conduct. IMSA-qualified companies stand as the benchmark for excellence in the life, annuities, and long-term care insurance industries.

As both a former regulator and company person, my views on the regulation of insurance are based and come from different vantage points. From 1992 to 1997, I served as the Superintendent of Insurance for the State of Maine, and in 1996 also served as President of the NAIC.

Life insurers face very intense market competition from other providers of financial service products, both domestically and internationally. In this challenging environment it is important that financial service companies follow high ethical standards to best protect and serve consumers and to make sure that the marketplace remains strong.

In an era when the practices of some financial service companies have come under intense scrutiny, IMSA provides clear ethical leadership through its principles of ethical market conduct, which includes specific requirements for the marketing, advertising, sales, and customer service of those product lines. IMSA principles also contain a "needs-based" selling standard to ensure that every consumer is given the opportunity to make an informed choice that meets their personal and financial goals. We believe that all consumers, certainly including our military service men and women, should receive clear and honest information before they purchase any type of insurance product.

A recent *Financial Times* article on the United Kingdom's financial services industry cited IMSA as a successful example of a principles-based, industry-led approach to raising ethical standards. We appreciated the notoriety, but in fact our focus is more here in the United States.

Insurance regulation is intended to ensure a healthy, competitive marketplace and to protect consumers. The history of market conduct regulation goes back to the early 1970's when the NAIC developed its first handbook for market conduct examinations and did its very first market conduct investigation. Things have proceeded and progressed quite a way since then.

Yet, as the GAO noted in its report issued last year, there has been little consistency or uniformity in the way that individual States perform market conduct oversight. For example, each company writing business nationally must comply with literally dozens of widely divergent State and Federal standards regarding the replacement of policies. There are no logical reasons for so many different and inconsistent standards or to impose the inherent extra and superfluous cost on companies and on the consumers.

The State-based system of market conduct regulation has been in need of improvement and updating for some time. And until a consistent nationwide system of regulation can be established, insurers will continue to be subject to simultaneous or overlapping market conduct exams from different States applying different laws and regulations, while consumers in some States receive little market conduct protection, as documented in the GAO study. This lack of uniformity places significant costs and human resource burdens on companies that translate into higher costs, ultimately passed on to consumers in the form of higher prices for their products.

There is a need for a uniform system of market conduct oversight that creates greater efficiencies for companies while maintaining appropriate consumer protections. There has been some recent progress toward improving this system. We commend the NAIC for its willingness to explore ways that regulators and best practice organizations such as IMSA can work collaboratively to improve regulation and advance the interests of consumers.

We certainly note with interest and cautious optimism the State regulators' current effort to establish a new market analysis approach to regulation that will hopefully reduce inefficiencies and better allocate resources to provide more comprehensive consumer protections. While this represents a step forward, the framework to implement this type of analysis remains under development.

We certainly have been pleased to respond to requests from the House Financial Services Committee regarding its efforts to encourage State regulators to collaborate with best practice organizations through the drafting of its smart document and by proposing the introduction of a uniform set of standards.

Establishing a uniform system of market analysis should focus on whether an insurer has a sound compliance infrastructure in place to better protect consumers. Today's market conduct exams all too often focus on technical instances of noncompliance, rather than exploring whether a company has a comprehensive system of policies and procedures in place.

IMSA qualification provides a consistent uniform template of market conduct compliance procedures and practices at all IMSA member companies that can serve as a national template. Insurers that qualify for IMSA devote considerable resources to maintaining these standards.

In the last 2 years, IMSA has gained greater recognition by regulators, rating agencies, and others. A growing number of State insurance departments use IMSA's qualification as a tool when planning and conducting its regulatory work, and we certainly applaud and note the efforts of the New York State Insurance Department, under Superintendent Serio, in these efforts. We would certainly like to see more States do so.

Consumers should be able to expect honesty, fairness, and integrity in their insurance transactions. Neither regulators nor companies alone can ensure that the marketplace is always operating in a fair and appropriate manner at all times.

In conclusion, IMSA member companies believe market conduct regulations should be more uniform and efficient. IMSA-qualified companies stand as the benchmark for excellence in the life insurance industry and would like to serve as a valuable resource for this Committee and the House Committee, and certainly to help others craft and implement true market regulatory reform.

We appreciate the opportunity to participate in this and will continue to work with you going forward.

Thank you very much.

Chairman SHELBY. I want to thank all of you.

Mr. Serio, during my opening statement I raised the threshold question about the overall soundness of the insurance industry. Would you please, just for a minute, provide your perspective on this matter, at least as far as things stand in the State of New York? And perhaps others can answer.

Mr. SERIO. In terms of financial soundness?

Chairman SHELBY. Right.

Mr. SERIO. In terms of financial soundness, I think not only do we have a high level of confidence into the overall safety and soundness of the insurance industry, both life as well as property and casualty, but also the regulatory system is actually taking on new ways of measuring it, adopting standards from the banking industry and from other financial services industries, and in fact, incorporating those standards that are utilized in other jurisdictions as well, notably in the EU and the United Kingdom.

What we are doing is we are getting a series of checks and balances together that really are giving us a higher level of confidence, not only as to the strength of the system, but that we also have an accurate sense of the strength of the system. A lot of air play between the States, early warning systems that have been put into place have also helped out in that regard, and early intervention in the event of an impaired insurance company has also been developed over the last several years.

We think that we have staved off a number of troubling insolvencies, as well as better managed the insolvencies we have had to deal with.

Chairman SHELBY. In other words, the system is working?

Mr. SERIO. Yes. There is not a question about it.

Chairman SHELBY. If I could, I will just continue with some basic questions. The word "insurance" is often used in a generic way. In practice, however, there is a wide variety of coverages and profits that fall under the rubric of insurance. Could you just speak on a few in greater specificity, the nature of lines of coverage, and provide us with a better sense about the wide range of products. We know there are many out there.

Mr. SERIO. If you could start with the general notions of the property-casualty and work your way through, and the interesting element of the regulatory system and what we think the strength of the State regulatory system is now is that we look at the industry as a whole instead of breaking it off, life insurance being regulated in one place, property being regulated somewhere else, maybe automobile insurance being done on a regional basis, but financial guarantee being done elsewhere. That is the range of coverage that you are talking about.

In addition to the range of the coverages that are currently under the regulatory umbrella of the State system, I can tell you there is no better measure of the strength of the State regulatory system to modernize itself. It has been the global acceptance of alternative risk transfer mechanisms, namely, captive insurance companies, that where the State regulatory system once known as to not be receptive and hospitable to alternative mechanisms, we are now appropriately regulating self-insurance mechanisms, workers compensation trust, and captive insurance companies. So we really are running the full range of lines of coverage, as well as the traditional versus the nontraditional.

Chairman SHELBY. As you regulate so many product lines, what are your specific challenges? Do they come and go, or is it product to product?

Mr. SERIO. Across the spectrum, the challenge has not so much been on the products. In fact, if there is an appropriate point of focus, and I think all of us mentioned it to varying degrees, it is on this idea that we spend so much time on prior approval of products that are largely already designated in terms of what is supposed to be n them by law. Yet we spend more time going through—and frankly, the regulator is doing a lot of the work of the companies in making a product suitable for the market.

What we have managed to do is kind of revisit what the insurance regulator's job is all about, and that is, we are financial surveillance monitors and we are market conduct monitors. That is the job of the insurance regulator, and I think we have gotten back to that across the spectrum.

Chairman SHELBY. Mr. Ryan, how important is it in the competitive marketplace for your company to develop new insurance products, and how many new products do you produce in a given year, or does it just depend?

Mr. RYAN. Well, a lot of my comments, Senator Shelby, were really based on what the industry does and what in particular my company does, and I was focusing on the competitive side of it because I do not think anything that we are arguing is for less regulation. We are talking for better regulation. We are looking for uniform standards. We are looking for consistency. That is what we want.

The big change that has occurred, and a lot of it from Gramm-Leach-Bliley, is lots and lots of people sell insurance products, not just insurance companies or independent agents. Banks sell them, securities firms sell them. So while there is a need to improve for all, there is also the issue of alternative products that bank security companies and others come up with that require a level playing field in terms of speed-to-market, not to put bad products out there, not to eliminate the regulatory process, but to be able to do something in less than 2 years, as was described by one of my colleagues earlier if you are going to make a change because you have to go to 35 different States.

Chairman SHELBY. Briefly, what process does your company, and I am sure every company, have to go through to get new products to market, assuming you have developed a product, you believe it is sound, you believe it will market? You have to go through the regulators, right?

Mr. RYAN. Most insurance companies are probably looking to bring somewhere between 8 and 10 new products a year, or modifications to their product. Some look to be even more aggressive in terms of enhancing the product.

The process is cumbersome. Today, we go to all 50 States. My company happens to do business in all 50 States. There are a number of other companies that do as well. So it is a procedure that we follow that is both time consuming and expensive and that requires us to go to every State in order to do it, and I would argue the distinction in life insurance and annuity products is not significant enough to warrant 50 different approvals.

Chairman SHELBY. Do you sell the same product in all 50 States or are there some products you do not sell in certain States?

Mr. RYAN. After the process they are different products because there are tweakings, there are changes that are done at each State in order to accommodate the requirements of a particular State regulatory system. I believe at the heart of the products they are fundamentally the same, but they turn out to be different, which again is an added cost burden because we do have to process for our clients against any changes that occur on a State level.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. I will yield to Senator——

Chairman SHELBY. You will defer? Whichever.

**STATEMENT OF SENATOR PAUL S. SARBANES**

Senator SARBANES. *The New York Times* in July ran a series of articles about the abusive practices with respect to our military in terms of the selling of insurance. I would like each of you to address that issue. First of all, do you accept the position that such abusive practices are taking place, and if so, what should be done about it?

Mr. HUNTER. There is no doubt that there has been abuses. They were well-documented in those articles, but they have been there for a long time and they have been ignored. They are beyond the reach of the State regulators. I think you are doing the right thing to ask GAO to look at it and come up with some Federal requirements on DoD or whoever to regulate it.

Mr. SERIO. From the regulatory community we have not thought that they have been beyond our reach. I think there is a significant issue of communication from Department of Defense facility officers, to the State regulatory mechanism. It has been our opinion that the agents who sell these products and the companies that provide the products are licensed by the States and they are doing the business of insurance within those States. And so we have been pursuing. Notably, the Georgia Insurance Commissioner has been pursuing this very aggressively, and other State commissioners have been reviewing sales practices, which is part and parcel of our daily job, sales practices on military installations, and working with the DoD to eradicate bad market kind of practices whether they are by agents or by the companies.

We also are looking forward to working with you and with the House in dealing with this issue on a more global basis so that those problems that Mr. Hunter said have existed—and they have—that they can be brought to light sooner. I think that has been a real part of the problem, that these issues have not been brought to light sooner to where there has been some consumer harm done because the problems have not been brought to the attention of the regulator sooner.

Mr. MCCARTNEY. Senator Sarbanes, USAA is particularly concerned about this because our membership is the active duty military. Our 5 million members consist of the active duty military, former military, and their families. We have 168,000 members in your State. Ninety-six percent penetration among the active duty officers, roughly 50 percent among enlisted. So these are our members who are being taken advantage of, and we are very concerned.

It points out to a degree how the current regulatory system is not working for our members.

Senator SARBANES. First of all, are industry people who are doing the right thing simply looking the other way with respect to those that are doing the wrong thing? And second, what should be done about it?

Mr. MCCARTNEY. Well, USAA certainly is not looking the other way. We are concerned about this. But I think there has been some concern among the State regulators about jurisdiction. Some believe that they do not have any jurisdiction on military bases and that continues to be debated in some quarters.

Our position is that we think DoD should have the assets and the financing to be able to deal with this, and it has been an area that has been cut back because of the need to respond to the deployment of more and more active duty military.

Mr. ATCHINSON. Senator, if I may?

Senator SARBANES. Yes.

Mr. ATCHINSON. There is certainly ample opportunity here. For example, companies have a certain responsibility for the education and training of those that sell on its behalf, and certainly built into the IMSA template is various significant requirements regarding the education and training of those who sell on their behalf. And we have been very pleased in fact to provide information to the Department of Defense regarding that simply as a possible template to employ to in fact address these sorts of issues.

Senator SARBANES. Anyone else?

Mr. SERIO. Senator, if I may. Any effort to help clarify the issue of the State regulatory authority over sales practices would be very helpful.

Senator SARBANES. Should a company be banned from the bases if its agents are engaging in these practices?

Mr. SERIO. My answer to that would be yes.

Senator SARBANES. What do the others on the panel think? Yes?

Mr. MCCARTNEY. Senator, we see no reason for some active duty private first class, who is 17-, 18-, 19-years-old, is not married, does not have a family—he can purchase $250,000 worth of Serviceman's Group Life Insurance for about $14 a month. We see no reason why some life insurance agent needs to come in and convince him to buy another $50,000 or $100,000. His life insurance need is served completely by that SGLI policy.

Senator SARBANES. Mr. Ryan, what do you think?

Mr. RYAN. Interestingly, our company is the administrator for the Serviceman's Group Life Insurance business and has been for about 50 years now. We, as a company, do not sell on military bases.

But I would agree with all of the comments that were made here. There seems to be a major gap between the Department of Defense and the State regulatory system as related to these practices. They seem to fall within the purview of State supervision and regulation that should close the gap and fix the problem.

Senator SARBANES. I am having difficulty understanding why, other than perhaps in an instance of absolute rogue agency, a company with agents that engage in this practice as this article detailed, keeps coming back around, why do we not just say you cannot go on these bases any more? What is wrong with doing that?

Mr. SERIO. Actually, I think that would be helpful, except that that would only solve half the problem, and what we do not want to get into——

Senator SARBANES. It is better than not solving any part of the problem?

Mr. SERIO. We do not want to get into an outside the gate kind of sales practice, where they are doing this just beyond the parameters of that Federal installation.

Senator SARBANES. Well, that is where you come in.

Mr. SERIO. That is true.

Senator SARBANES. So you think you have a jurisdictional problem outside the gate?

Mr. SERIO. No, what I am saying——

Senator SARBANES. You do think or at least some of your people think you have a jurisdictional problem within the gate; is that correct?

Mr. SERIO. Some people are concerned about that. I do not think we have a jurisdictional problem in or outside the gates. But my point is this: We have to get to the underlying problem, which is the aberrant market conduct behavior, whether it is of the agent or the company itself. And by tightening that communication link between DoD and the State regulators so that you can cover both the inside the installation and outside the installation sales practices so that you are protecting the servicemen and their families wherever they may be buying insurance, that is the best way to approach this.

Senator SARBANES. Is there anyone at the table who would have difficulty with a company being banned from the installations if it is shown that their agents are engaged in these abusive practices? Anyone have any problem with doing that?

Thank you, Mr. Chairman. The record should indicate that no one indicated they would have a problem.

Chairman SHELBY. Senator Dodd.

Senator DODD. Senator Dole is——

Chairman SHELBY. Oh, excuse me again. I guess I am trying to get you and Sarbanes together here.

[Laughter.]

Senator Dole.

Senator DOLE. Thank you.

Senator DODD. At least you did not call me Hagel.

[Laughter.]

Chairman SHELBY. No, Hagel will not be mad at me. Just the end of the day.

Senator DOLE. Superintendent Serio, as the insurance regulator from a State, that like my home State of North Carolina, has passed a reciprocal licensing law, would it be helpful if Congress passed follow-up legislation to NARAB to make reciprocity a reality in every State? I know that two of the States that have still not acted are Florida and California, two States that represent a large portion of the market. Should they not be brought into the fold, too?

Mr. SERIO. Well, I think that the California and Florida insurance commissioners have good reason, and their legislatures have good reason for acting the way they have. It does create or it prevents us from having a fully uniform system and reciprocal system across the country.

But your question gets to the heart of whether we should have legislation dictating these things. Part of this goes to the economic competitiveness of one State versus another. Part of it goes to the larger issues that are involved in the sales of insurance in those States. We certainly, and I think the NAIC has been pushing uniformity of agent licensing and other processes across the spectrum, whether it is in Florida, California, or even in New York, and there may be one or two points where New York deviates from the rest of the marketplace, but we have been reducing those.

But the fact is I think we have been working with both the California and Florida insurance departments to get through their issues with respect to that so we can get full compliance on the uniformity and reciprocity for agents. There is nothing that we could get better benefit from, particularly because of its ease of applicability to technology to get uniformity and reciprocity and make the agent licensing system a single stop electronic process: No paper, no moving around from one State to the next.

I think that would be ideal for all the States.

Senator DOLE. Thank you.

I have two questions I would like to ask the entire panel to respond to. I would appreciate a brief response. First of all, Congress may not have set the bar high enough in NARAB, and we still need to bring the last few States into the fold. But has Congressional enactment of NARAB reforms made agent licensing any easier today than it was prior to Gramm-Leach-Bliley?

Mr. RYAN. Yes.

Senator DOLE. Right down the line, please.

Mr. MCCARTNEY. Senator Dole, it has made it worse for us. We do not use agents. We sell directly through our employees. Before, we had about 150,000 licenses; now, we have about 250,000 licenses. And it makes it extremely difficult for us. The categories of licenses in the NAIC Model Producer Act are property and casualty.

So we are the fifth-largest writer of homeowners, the seventh-largest writer of automobile insurance. We do not write medical malpractice, workers compensation, boiler and machinery, or any of the commercial lines. Yet, in many States, our agents have to take tests over commercial lines in order to get a license, and then, they have to take periodic continuing education in those lines to maintain those licenses.

It is ridiculous. It is a bizarre system. For us, it has gotten more expensive. We have had to have more licenses. It has not worked; in fact, it has made it worse for us.

Mr. HUNTER. I would say generally, it is better, but there are these exceptions, and I think they need to be dealt with and worked on but generally better.

Mr. LIEBOWITZ. Senator, I really do not have any personal information on this, but we will check with our membership and get back to you with a written response.

Senator DOLE. Thank you.

Mr. AHART. Senator Dole, as an independent agent, it has made it much easier in those States where it has been adopted. With globalization, as you have mentioned before, we have customers who are moving from State to State, opening offices in different States, and we need, therefore, to be licensed in more than one State, which we did not have to be. And in those States that are complying, you can get compliance within 1 or 2 weeks sometimes now, which is very easy. But those States that are not complying can still be 6 months, which is ridiculous, and that is why I think it needs to be mandated to all those States and be uniform.

Senator DOLE. Thank you.

Mr. COUNSELMAN. Senator, the association I represent, the Council represents eight places, 80 percent of property-casualty insurance in the United States and overwhelmingly, it has been easier for our group, and we feel that we need 100 percent reciprocity, but we are much ahead of where we were in 1999. Thank you.

Mr. ATCHINSON. Thank you, Senator. Our members are from the life side, and I think, by and large, they would say it has improved, but there is still opportunity for further improvement, particularly with respect to oversight of appointments and things like that which, at times, is unnecessarily duplicative and extraneous.

Senator DOLE. Yes.

Mr. MCCARTNEY. May I just offer one more anecdote? We have an office in Tampa. The other day, Tampa was closed because of the hurricane. So all of those phone calls, then, from that area of the country rolled to our other regions. And somebody might be calling in and want to deal with a mutual fund or any one of the other products, and it is not a problem, because those calls can roll from Tampa to Colorado Springs, Sacramento, or anyplace else.

But when Tampa is closed, and somebody from Alabama calls in, and we need an Alabama-licensed agent or a North Carolina-licensed agent, and it rolls to Colorado Springs, that member may be on the phone for three or four minutes while we find somebody licensed in those States, so it really does present a problem for us.

Senator DOLE. Thank you. Appreciate your adding that comment.

Can the NARAB approach be used to improve other areas of State insurance regulation that are in need of modernization? Could we go right down the panel again, brief answers?

Mr. SERIO. I do not think there is a question about it. In fact, I think the House SMART draft goes in that direction, taking the benefits of the NARAB construct and putting it across the line. The NAIC has been in concert with the House road map; in fact, we had our own road map that looked a lot like the House road map, because we did focus on uniformity and using the NARAB-type process to get there.

Mr. RYAN. Yes, any activities that deal with agent licensing or product approval or market conduct on a uniform standard basis is highly desirable. And we would certainly support that. As I mentioned, the ACLI, on track one, is working very closely with the States to do that, but we also believe that as long as there is going to be ability to opt out, as long as there are going to be different interpretations, having an optional Federal charter is a reasonable alternative to State regulation.

Mr. MCCARTNEY. Senator, it would take a heck of a lot more work than the current system. The two main problems with NARAB: First, when it was enacted, it talked about State licensing laws that are reciprocal or uniform. If it had said reciprocal and uniform, we would have been in pretty good shape. But when it said reciprocal or uniform, it really gave the States a dodge, and they immediately decided, well, we will never get to uniformity, so let us get to reciprocity. The standard is much lower.

The second problem with it is that it gives to the NAIC the power to determine whether or not a State is in compliance. There are a lot of provisions that should be in those laws that the NAIC has said no, they do not have to be in there; you are reciprocal, and that is the fox in the hen house.

Mr. HUNTER. This is not the first time that a Federal interest has caused a positive change, at least some people think it is positive. The guarantee funds were created because Warren Magnuson was interested and pushed and talked about legislation, and then they were improved when John Dingle got very excited about solvency and guarantee funds.

The Congress has historically played that role, with or without a specific legislative final product. And that is a positive role. However, it can be very negative. The SMART Act on the House side is terrible for consumers, and I have a letter attached to my testimony. I have a letter attached; I think it would be a very bad idea, and I think it would harm consumers greatly if it were passed.

So it depends how you do it. I think there are ways to achieve uniformity, in my statement, without gutting consumer protections, and I think that is an important aspect of it.

Senator DOLE. Thank you.

Mr. LIEBOWITZ. I would agree with Mr. McCartney's statement. The NARAB model as a solution is an inadequate solution. It is a Band-Aid on what would be a very large wound, and the reality is there are too many exceptions. We do not end up with uniformity. No, I do not believe it is an adequate solution at all.

Mr. AHART. Senator, I, on the other hand, think it is the perfect solution.

[Laughter.]

I think the insurance industry seems to make everything so difficult and complicated at times. Everybody here and in other panels that I have participated on really state three issues: And it is licensing, speed-to-market issues, and market conduct. Those things can all be handled by the NARAB approach. And for those who say we should just continue with a State approach and do nothing and hope it gets better does not seem to make sense.

For those that say we should scrap the whole system and go to a new system where we do not know what we are going to get and all the other issues like consumer protection but to solve those three issues does not make sense. But there is a middle ground approach using legislative tools like the NARAB approach, which will handle those specific problems and allow the other things that are going well to keep working.

Mr. COUNSELMAN. Senator, in the commercial insurance property-casualty marketplace, we definitely need surplus line improvement. More and more of the market has become surplus lines, the nonstandard types of coverages or high limits of insurance, whatever it might be. And the State laws are absolutely conflicting, and it is absolutely impossible to comply with State laws where coverage is written across State lines when there is a surplus lines filing that has to be made in multiple States.

And so, that could be improved through legislation.

Mr. ATCHINSON. Senator, in my testimony, I noted and commended the efforts of the NAIC currently underway to bring about some greater efficiencies and to modernize the oversight of market conduct. On the other hand, some of the concerns that I expressed and others have raised is will all of the States buy into this? Will all of the States start marching to the same drummer while not in any way diluting consumer protections?

I think that remains the question. So in theory, I think the NARAB approach has a lot of viability. The question is can one enhance the incentives, as well as enhance the disincentives for States, in fact, to get on board and to do what can be done and should be done.

Senator DOLE. Thank you very much.

My time has clearly expired. Thank you, Mr. Chairman.

Chairman SHELBY. It is okay. It is very important.

Senator Dodd.

Senator DODD. Thank you, Mr. Chairman.

Let me commend my colleague from North Carolina. You have some very good questions and cover a lot of the issues that I was going to raise.

First of all, let me thank all of you, your comments about TRIA, with the exception of Mr. Hunter.

[Laughter.]

Mr. HUNTER. You are welcome.

Senator DODD. No, no, I wanted to give you special recognition, Mr. Hunter——

[Laughter.]

—for your observations, and I appreciate them as well, but it is, I think, helpful to hear from across the spectrum on such an important issue, and I mentioned earlier Senator Schumer's participation as well and Senator Bennett and others on this, so I appreciate that, and I will not dwell on that here.

We have raised a lot of issues, and the speed-to-market issue, I was going to ask you, Art, about, but I think you have covered it pretty well, the importance of that issue and questions and the licensing issues, as well. Your testimony, Mr. Counselman, and your comments about the number of licenses required out there is pretty overwhelming. While, certainly, things may be improving, there still is a tremendous amount involved.

And I think this is very important. I thank the Chairman for having a hearing on this subject matter. Again, Senator Schumer has had a longstanding interest in this subject matter as well, and I have not formed any final opinions on the subject matter, but I think having a discussion of this issue is tremendously important for the Committee as to how we should proceed on the issue of a Federal charter and how you work with that in terms of the tremendous efforts to be made at the State level and the importance of that as well.

I think we would be remiss in this hearing here if we did not touch upon the more timely subject matter. I note that our colleague from Alabama has been working tirelessly on behalf of his constituency, who were hard hit by Hurricane Ivan a few days ago, and I am very interested to know how well the insurance industry is responding to that; obviously, there are those of you here who can respond more directly to that question, but I would like to know whether or not, in fact, claims are being paid in a timely fashion; what are your records showing, and are there any solvency issues that we should be aware of here on this side of the dais about the industry itself as a result of this rather heavy period we have gone through now and the tremendous cost effect on the insurance industry itself.

So we would be, remiss not touching upon it, but I want to begin by commending the Chairman for his work on behalf of his constituency. Would you address both questions? I realize some are in a better position to address this than others, and I will let you decide.

Mr. COUNSELMAN. Senator Dodd.

Senator DODD. Yes.

Mr. COUNSELMAN. I would like to respond from the standpoint that before the hurricane struck, a number of the insurance companies had already positioned adjusters and notified agents and brokers of that so that there would be an initial opportunity to respond immediately through whatever mechanisms would be available, knowing that there would be limited communications.

The insurance companies anticipated this and tried to, as best they could, stage their people and, in addition to that, from a financial standpoint, most of them have the benefit of purchasing reinsurance. And it is natural catastrophes, fortunately, are more planned and more predictable than the terrorism-type risk, so from the analyst reports that I have been reading over the last week or week and a half, I have a feeling of confidence.

Now, this is early on, and we do not know what might be reported in the coming weeks, but at this particular point in time, the property-casualty industry seems to be responding and on time and has the financial resources to deal with this.

Senator DODD. So you do not see any solvency issues at this juncture.

Mr. COUNSELMAN. There may be from some companies but none that have been reported from the standpoint of major companies that are followed by the investment analysts. I daily read reports, and I have not seen reports of concern about insolvencies. It is obviously early.

Senator DODD. Anyone else want to comment?

Mr. SERIO. Senator, if you look back to after Hurricane Andrew, approximately 10 companies went broke in Florida alone.

Senator DODD. Hence the emergence of the reinsurance industry.

Mr. SERIO. Right, the backstops that were put into place both on the primary side and on the reinsurance side really secured the Florida marketplace, and that is why we do not have those very same solvency issues today that we did 12 years ago. In addition, the coordination of the response effort has been greatly enhanced by, of all things, an interstate compact among the emergency managers, where the flow of assets going into Florida, Alabama, and other affected States has been far more coordinated, far more organized, and so, you actually have a better utilization of insurance industry assets and public assets together, because it has all been done on a coordinated basis, including the adjusters not only being put into place by the industry but also then being allowed access into the affected areas because they are now part of the disaster response protocols in Florida and in the other Gulf States.

Actually, the system has worked out, particularly given the gravity of the situation, the system has worked out much better than it did during Andrew, and I think we have learned the lessons that I think were put into place since Andrew, September 11, and things like that.

Senator DODD. Anyone else want to comment on that?

Mr. McCARTNEY. Yes; Senator Dodd, as representing the fifth largest homeowners company, and we have 77,000 members in the Chairman's State, we are going to see a large percentage of those members have claims. We have had people there since the hurricane hit.

For us, even though we now have had three major hurricanes hit this year, it will not be a major financial impact to our company. What bothers me personally more than anything is Professor Bill Gray from Colorado, who is the guru on this, who says that after a period of relative quiet, we are moving into probably 25 to 30 years of more advanced hurricane activity. And we are fine this year, I think. There may be one or two Florida only companies that might be in trouble; I do not know; that is pure speculation, but speculation has never stopped Hunter.

[Laughter.]

Senator DODD. I am just curious: Has your company made any preliminary decisions about whether or not you will write more insurance in places like Alabama and Florida as a result of that prediction? Are you going to see somehow a retreat from that market because of the predictions of 25 or 30 years of a hurricane season? Have you calculated that into your decisionmaking business practices?

Mr. McCARTNEY. Not that I know about.

Senator DODD. I am sorry. Mr. Ahart.

Mr. AHART. Yes, Senator Dodd, I would just like to say from an agent's perspective that we have talked a lot to our agent friends and brokers down in Florida and Alabama and those areas, and they were hit as well as agents and brokers, and people have sent staffing down there, and those people have been servicing and been open weekends and nights, and things seem to be working very well. Insurance companies are giving advances for people to get themselves back on their feet and start their cleanup, and I think it also shows that State regulations actually worked down in Florida with the CAT funds and that the markets are still available down there.

And now if we can just get them to do license reciprocity down there, it would be great.

[Laughter.]

Senator DODD. Take advantage of that opportunity.

Mr. AHART. Exactly.

Senator DODD. Anyone else want to comment on this?

Mr. HUNTER. Let me just say one thing: We have been talking to a lot of the consumer groups down in Florida and Alabama and so on, and they report that, as we find in other natural disasters, the initial response of the insurers has been very good. They have been out fast into these places. The problems that develop, if there are any, will usually be the ultimate, final payments, which may be months away.

Senator DODD. Yes.

Mr. HUNTER. Normally, the first few months work out pretty well, and it seems to be what is happening now.

Senator DODD. I am sure the industry will be mindful of the fact that the Chairman of the Banking Committee comes from Alabama, has a passing interest in the subject matter at hand here today.

Last, not asking for any response in this, but in my conversations with a number of you, particularly my conversations with Art Ryan, who I have known, as I said, at the outset for so many years, the distinction between life and property and casualty, obviously, I come from a State where this industry is more than just a cottage industry, and believe on the Federal issue, it is an easier question, I think, for many of us here on the life issue in some ways than the P&C issue, for all of the obvious reasons that have been raised by many of you here, and I think it is important.

I think the Chairman raised that issue earlier, that we use the word insurance rather generically, and there are a lot of different products being offered, and you have to think about this on a variety of different levels in order to respond to one of the underlying questions before us today.

But I think I would be remiss if I did not mention that I do appreciate the distinctions, and there is some universality in the life issues that are less evident in the property and casualty areas, for instance, that certainly, we would have to keep in mind as we consider moving forward in this area. But again, Mr. Chairman, I thank you for having the hearing. This was very important. I know Chuck Schumer and I have talked about this in the past. I have a discussion with people who work in this industry every single day, and your contribution to this, the body of evidence we will be building on this debate is extremely important, so I thank all of you for being here.

Chairman SHELBY. I have recently toured parts of Florida and Alabama both with Governor Riley and President Bush, and it has looked to me like there were a lot of insurance adjusters, insurance agents everywhere down there, and this is early on, as someone said, but I think that the people were anticipating what was going to come our way, and they are down there, and I hope they continue until they make everybody happy.

Senator Sununu.

Senator DODD. Thank you, Mr. Chairman.

Chairman SHELBY. Yes, sir.

Senator SUNUNU. Thank you, Mr. Chairman.

Mr. Serio, how many different State price control laws or rate review laws are there?

Mr. SERIO. Depending upon what line of insurance, they will vary.

Senator SUNUNU. Property and casualty.

Mr. SERIO. Property and casualty, there are four essential differences: Open competitive rating——

Senator SUNUNU. No, but how many different laws are there nationwide?

Mr. SERIO. There are dozens.

Senator SUNUNU. Dozens? Less than 100?

Mr. SERIO. Less than 100 probably. I cannot say for sure, but——

Senator SUNUNU. Anybody want to agree or disagree with that number, Mr. McCartney?

Mr. MCCARTNEY. There are, if you include the District of Columbia, there are 50. The only State that does not have one is Illinois.

Senator SUNUNU. So one law for each State?

Mr. MCCARTNEY. That is right.

Senator SUNUNU. Mr. Serio.

Mr. SERIO. Actually, that is different. There are different rating laws for different lines in each of the States.

Senator SUNUNU. Thank you; yes, I think it is certainly more than 50. How about product review laws?

Mr. SERIO. There are different product review laws depending upon commercial or personal lines within property-casualty in each of the States. There has been movement away from product approvals on the commercial lines and focusing more on personal lines. There are generally uniform rules with respect to product approvals in those specific areas like personal lines.

Senator SUNUNU. So you have dozens of different rate review laws and dozens of different product review laws. Explain to me how, regardless of whether you want to make an argument for this many laws, explain to me how industry-wide self-policing, which you highlight as the key to better efficiency here, will enable the industry to overcome dozens of different price control laws.

Mr. SERIO. I am not going to advocate for dozens of different rating laws. Let us make that clear. There are a couple of ways you can do this, but that self-policing issue, and this kind of goes a little counterintuitive to what you might typically think, but that self-policing and the discipline with respect to rating laws goes as much to how far rates go down as much as how much or how far rates go up.

And let me explain that in 30 seconds. The problems for the marketplace have been, and the reason that there are rules in New York and other States about adequacy or the fairness or unfairness of rates is because since this is a financial product that people are buying for a future promise to be kept. You have to make sure that companies have adequate resources to meet those obligations.

There have been instances where you have open rating where there has been overheated rate competition, resulting in insolvencies of insurance companies, because it was driving the prices below where they really need to be. There has been widespread success around the States using rate floors and rate ceilings and flex bands, as we call them, to allow competitive opportunities within those flex rating bands. We have used them in New York for a number of years and in many other States, allowing that level of competition to go on without rates getting to such a point where they are actually financially inadequate for meeting the promises going forward.

Senator SUNUNU. So you are making an argument for price controls that they are needed so that insurance firms do not compete too aggressively and lower their prices too much because the shareholders and the management at those companies cannot exercise sound long-term decisionmaking.

Mr. SERIO. It goes to the question about self-policing. In fact, there has been a lot of discussion as the property-casualty industry has come out of the hard market, whether you are talking about from the head of AIG, the Travelers, the Hartford, Liberty Mutual, or any of the other companies, they have spoken about the need to maintaining rate discipline. They have acknowledged there has been a lack of rate discipline in the property and casualty market.

Senator SUNUNU. I think that is a fair point to make if you believe it, and obviously, you do. Now, but I have rarely if ever heard someone arguing for price controls to prevent consumers from getting the lowest price that would be offered in a competitive environment, number one.

Number two, I do not want to ascribe motives to anyone, but let us just say I am a large, successful insurance firm with very strong market share. The idea of having a price band that would limit competition and thereby reduce threats to my market share would not necessarily be either a bad idea in the short-term or against my shareholders' interests in the long-term, but it would be anticonsumer. And you do not need to respond to that. I just want to point out that there may be some other motives driving some of the big firms, not necessarily the ones you mention, but big firms that are well-positioned.

Let me ask you another question about the work that the NAIC has done, and I absolutely recognize the Association cares about this issue, has worked very constructively on this issue, and to the extent that there is any frustration or interest in looking at legislation, it has to do with the pace. And you have been the first to recognize that, and I appreciate it.

Could you talk to me a little bit about the Statement of Intent that was put out in 2000 by the NAIC and the action plan that was put out last year? Just talk a little bit. I know we do not have tons of time, but I guess I am only cutting into Senator Schumer's time right now. I apologize.

[Laughter.]

Talk a little bit about what was in those plans and what has really changed from 2000 to 2003.

Mr. SERIO. As long as Senator Schumer does not hold it against me as his domestic regulator, I will give you as much detail as you like.

Senator SUNUNU. That is part of my plan is to drive a wedge between you and Chuck.

[Laughter.]

Mr. SERIO. We smoked him out.

Senator SCHUMER. You mean the free-market Democrat and the regulation-oriented Republican.

[Laughter.]

I understand.

Mr. SERIO. I said it was counterintuitive so——

Senator SUNUNU. I think there is only one person in the room that has actually dropped an OFC bill.

[Laughter.]

Mr. SERIO. It was important for us to do an update in 2003 where we have come from. If you go back to the 2000 Statement of Intent and the things that were in it, you can find the roots of a lot of the progress that now have made in that Statement of Intent; for example, the CARFER process, which was the rate and form review process, and has morphed into both the interstate compact idea and the national standards work that Commissioner Bell has presented to us in terms of the first national standards.

That work was done specifically as a result of the Statement of Intent, and the work started under the Statement of Intent. Those national standards will be done by the end of the year in life insurance, the first round of national standards will be done, and we will have made significant progress together with the industries. It is not the commissioners bringing it down from on high or anything of that nature; these are discussions that have gone on between the industry, the consumers, and the regulators to make standards that work. That is a direct consequence and a positive consequence of the Statement of Intent.

The national treatment of companies, this has not been lost on us in terms of needing to create uniformity where there is clearly a need for uniformity across State lines. That continues to work. I think NARAB really helped drive that, and I think NARAB together with the Statement of Intent have made that a reality.

The Statement of Intent, the restatement in 2003, and the NAIC road map, which we put out in response to the House dialogue that we have been very happily a major participant in, really has shown the progression in the NAIC's responsiveness, and in addition to the NAIC as the regulators, the State legislative response to these things, the NCOIL market conduct bill, quite frankly, it was something that the NAIC could not do, but the State legislators got a market conduct bill done.

And now, again, taking it back to the State legislatures, now, we can all coalesce around that and drive that in the State legislative process, and I think that will be a real positive development, again, coming out of not just a Statement of Intent but the working coalition that we have had with the National Conference of State Legislatures and with NCOIL but not in any small measure because of the continuing interest of the House and of the Senate in the progress that is being made under the Statement of Intent.

Senator SUNUNU. Thank you.

Chairman SHELBY. Senator Schumer.

Senator SCHUMER. My time has expired.

[Laughter.]

Chairman SHELBY. We will give you a reasonable amount.

Senator SUNUNU. It was a great series of questions that you had on your time.

Senator SCHUMER. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sununu yields you a little bit of time.

Senator SCHUMER. A little bit of his remaining time.

**STATEMENT OF SENATOR CHARLES E. SCHUMER**

I want to thank you for holding this hearing, which is timely and important. This is one of the major issues we are going to have to grapple with in the next Congress, and I think it is great to get people thinking about it now. I want to welcome our two New Yorkers on the panel, our Superintendent, Greg Serio, who does an excellent job in one of the premier offices in the country in terms of insurance regulation and also Mr. Alan Liebowitz from the great county of Westchester, somewhat north of Brooklyn.

[Laughter.]

First, I want to get into a little bit of the substance of this issue, but like some of the others who are here, Mr. Chairman, the renewal of the terrorism insurance is really important, and first, I guess could it be uniformly assumed with the exception, as Chris Dodd mentioned, of Mr. Hunter that everyone here would like to see TRIA renewed as quickly as possible? Raise your hand if you do not feel that way.

[Laughter.]

Let the record show one hand against and all the others for.

And I just wanted to ask Mr. Serio to outline briefly how successful it has been in New York, where obviously, we had the greatest impact given September 11 and given so many buildings nearby and if there is any basis for believing that reinsurers will rush into the risk insurance market next year, reducing the need for a Federal backup, which is what some of those who say we should not rush to do this should do?

Mr. SERIO. I will take the second part first; no, I do not think there is any reason to believe that there is going to be a greater rush of the reinsurers than we have seen over the last 3 years. In fact, going back to that notion of rate discipline and underwriting discipline that the carriers are all extolling that, in talking to colleagues, I do not think you have seen that rush back, and I do not think you are going to see that for the foreseeable future.

Here is the other thing that TRIA has done not only for New York but also for the other States that have not made changes to their laws with respect to exclusions for terrorism or with respect to changes to the standard fire policy, and that provides coverage regardless of the source of the fire.

TRIA has allowed New York to keep its laws largely intact. We have not had to rely upon broad-based exclusions for terrorism coverage, for biological, chemical, or nuclear, things of that nature. We have not had to amend the standard fire policy, which was started in New York State; other States have felt they have needed to do that. Because of the availability of terrorism insurance coverage, we have been able to keep our laws intact; we have been able to continue construction of new real estate projects in New York, and most importantly, whether small businesses or large businesses, they have been able to find the terrorism insurance that they have needed, whether for their financial arrangements or for their own peace of mind.

Senator SCHUMER. All right; and you do not see any change next year. In other words, if, for some reason, we were not to renew TRIA, things could go back to the way they were, or do you think some people wanted TRIA to be temporary; that is why it is a limited number of years and said we just needed it temporarily. Tell me your feelings about that again.

Mr. SERIO. The writing is already on the wall. The property-casualty insurance industry has asked for conditional endorsements or popup exclusions for terrorism coverage in the event that TRIA goes away. That clearly is telling you where this marketplace is going. In addition, if the bill for extending TRIA extends to group life, which we really think it must do that is a marketplace that the Treasury Department has acknowledged has been largely devoid of reinsurance throughout the last 3 years, and I do not see reinsurance capacity coming back to the group life business anytime soon either. So and group life only makes it that much more important to get it done.

Senator SCHUMER. By those facts, which I have no reason to dispute, it makes logical sense to renew it this year and avoid all the pain, anxiety, uncertainty and let this hang out, because we know what happened when we tried to get this done the first time.

Mr. SERIO. Without question.

Do you want to say something, Mr. Counselman?

Mr. COUNSELMAN. Yes, Senator, there has not been reinsurance protection for the 10 percent retention, and next year, it goes to a 15 percent retention.

Senator SCHUMER. Right.

Mr. COUNSELMAN. So, I expect that as those of us who are selling the product to commercial insurers, primarily, we think it is going to get worse.

Senator SCHUMER. I would just urge that we try if we can. I know the gates are closing on this year's session, although we may be back after Election Day to try and renew TRIA. It makes no sense to delay it.

Okay; I know you probably disagree with that, Mr. Hunter.

Mr. HUNTER. Totally. I have already explained why.

Senator SCHUMER. Yes, I know. God bless you.

[Laughter.]

Well, I meant that seriously on many issues.

Mr. HUNTER. He has, thank you.

Senator SCHUMER. The basic issue that we are here about is an optional Federal charter, and I agree here with my colleague from New Hampshire, who always does an erudite and thoughtful job on these issues when we agree and disagree. The bottom line is, in this fast-moving world, where so many new products come out so quickly, where international competition is much greater than it has ever been, to have 50 State regulators at least as a mandate does not make much sense from an economic point of view anymore, and I do not think that is disputable.

I understand the State regulators have done a good job, but it is a different world. The real issue here, is at least for somebody like myself who believes that you do need some limits and some regulation, how do you get to a Federal charter and yet ensure consumer protection standards do not fall to the lowest common denominator. We have had this in certain other areas, where you get Federal regulation, banking, where we have much more national regulation, and it is the same type of industry. It is not any different in terms of being fungible financial products; and yet, in certain areas, predatory lending, there is an attempt to move to the lowest common denominator standard when different States would want to do more, and it really does not interfere with the free flow of commerce of banking products and everything else, and we have had a couple of pretty contentious hearings about that right here in this room several months ago.

So my question to any of you and all of you is how do you have the baby in the bath water, meet the new economic changes, but give the States some flexibility on areas that do not deal with the fundamental sinew of, if you will, interstate commerce or even international commerce in a world where things move very quickly? Can you have your cake and eat it, too? How do we accomplish that?

That is the great dilemma facing people at least from my point of view. We will just start from the right and move our way to the left. Mr. Counselman had his hand up first.

Mr. COUNSELMAN. Yes.

Senator SCHUMER. You do not have to answer. Just as the charter is not mandatory, neither is the requirement of an answer mandatory here this afternoon.

Mr. COUNSELMAN. I would urge that the NARAB approach be the approach, and that approach would set minimum standards, and those standards should be high, so that an individual State who does not care to set high standards would have to at least meet the minimum, and what they do beyond that is another issue.

Senator SCHUMER. Do you think the politics of the Congress would allow that?

Mr. COUNSELMAN. I am not an expert on that.

Senator SCHUMER. Right; that is my worry.

Go ahead; Mr. Ahart.

Mr. AHART. I mean, I agree with Mr. Counselman that the NARAB approach is the right approach. I mean, everybody is trying to do the right thing and attack the right problems, but the problem, as you mentioned, with a Federal charter, even if it is optional, first of all, it is not optional for agents or brokers. There are companies we are going to have that will be Federal, there will be companies that are going to be State, and we are going to be dealing with both of those, as are some consumers.

But the issue is that throwing out the baby with the bath water is that you are going to an unknown on those consumer protection issues and other issues, and I would say that banking and insurance are different in some ways, and for instance, auto insurance in New Jersey is a lot different than Alabama, and that is different than banking, where it is probably pretty much the same with interest rates and things like that.

I think you need to use a legislative tools approach, where you attack those specific problems, and you could use the NAIC models where the majority of States come up with a model, and then, it is mandated that that is what the standard would be.

Senator SCHUMER. Did you say something, Mr. Liebowitz?

Mr. LIEBOWITZ. Yes, the consumer issues can be addressed at the local level even while still having the optional Federal charter. We have a great track record to look at in terms of where did we see abuses, both at the banking level and at the insurance level. This is an opportunity to write fresh legislation to determine exactly where the responsibility should lie, and who is in the best position to be able administer.

This is an opportunity to undo 140 years of patchwork type of regulation and replace it with a modern system that will help both the consumer as well as the providers.

Mr. HUNTER. We have not seen an optional Federal charter bill that did not encourage a race to the bottom that you had mentioned. If you could create one with some minimum standards, that might be the way to go or to use, to empower the NAIC to do certain things. I think you can achieve uniformity without going to the lowest common denominator standards. I think you have to start with high standards.

Senator SCHUMER. Right; if you could avoid, "the race to the bottom," would you be supportive of an optional Federal charter, Mr. Hunter?

Mr. HUNTER. I do not know how you do it but if you——

Senator SCHUMER. Just assuming you could.

Mr. HUNTER. What we would look at, we listed several pages of principles by which we would judge a bill. If those principles are met, we could support a bill.

Senator SCHUMER. Right; and I am not on top of those pages that you put out. Would they undo the whole idea of one national regulation?

[Laughter.]

Mr. HUNTER. No, no, in fact, what we clearly said——

Senator SCHUMER. It is a give and take here. It really is.

Mr. HUNTER. If you were here when I spoke earlier, you would have heard me say if there is one thing we want you to take away from this is consumers do not care who regulates.

Senator SCHUMER. Right.

Mr. HUNTER. We do care about the quality.

Senator SCHUMER. Mr. McCartney.

Mr. MCCARTNEY. Senator, with our mobile membership, it would not be unusual for somebody from Alabama to be stationed in Georgia and sent to Alaska. And while he is in Georgia, he buys a company issued by a Texas company from an agent licensed in Georgia. He moves to Alaska and has a problem with that policy, and the company is not admitted in Alaska. So the Alaska regulator says I cannot help you. He goes back to the Georgia regulator, and the Georgia regulator says you are no longer a citizen of my State, I cannot help you either. And he calls Alabama, and Alabama says well, neither the company nor the agent is licensed here; I cannot help you.

The current system is not perfect. That member of USAA would be better off being able to go to a Federal regulator and saying hey, I need some help here. And we believe that an optional Federal charter represents the best method to do that. The State-based system stays in place for the companies that want to be regulated there and consumers that want to deal with a State-regulated company, and the national companies doing business in 51 jurisdictions then have a single shop, and the Senate and others, when they have a problem with a company, have a single regulator to go to to get some answers.

Senator SCHUMER. And how frequent is the situation you mentioned where one seller, agent, or whomever, falls between the cracks in different States?

Mr. MCCARTNEY. It is not unusual for a mobile membership like ours. You know, there are a number of companies that do business in one State or three or four States; some that do business only in one or two counties. So, you know, that is not unheard of.

Senator SCHUMER. That's correct; Mr. Ryan.

Mr. RYAN. Ironically, what the State superintendents are trying to do today is to try and answer your question, only to do it among the 50 of them. There is absolutely no reason to believe that an optional Federal charter has to be weaker in this regard than a uniform set of standards across 50 States. The notion that we simply want the weakest standard, fish to the bottom or whatever the phrase is, is nonsense.

We understand the need for strong regulation. This is not deregulation. This is uniformity, speed-to-market, and more competitiveness.

Senator SCHUMER. And do you think some of the major companies, the large national companies like yours that care most, I guess, about this would be able to resist the race to the bottom and say, well, when we actually put together legislation that we will support some modicum of reasonable standard? I think that is a key, and I hope it would happen.

Mr. RYAN. I think it has happened. I mean, working with Superintendent Serio, who is an outstanding superintendent; we have worked on national standards with the NAIC. We have worked on various things. The compact was raised a little bit earlier. The difficulty is there are only nine States in the compact.

Senator SCHUMER. Right.

Mr. RYAN. That is the dilemma that we face, not that we do not want to have uniformity or work with the Greg Serios in this world. It is a question of needing an option in order to get all of what we are looking for, which is strong regulation, but competitiveness as well.

Senator SCHUMER. Well put.

Mr. Serio, you get the last word.

Mr. SERIO. If everybody wanted to go to the highest standards, all the companies would be domesticated in New York or in California.

[Laughter.]

I mean, there is a reality to that, that they go around; there is a fair amount of forum shopping that goes on.

In fact, in the discussions that we have been having with the House Financial Services Committee and with others inside the NAIC, the discussion has been on how do we regulate it now, whether we have an Federal charter or not, because there is already some disparity between the home regulator and the regulator who has the largest market share of a company.

Senator SCHUMER. Right.

Mr. SERIO. And I think that is really getting to the question of what portal do you want to use? The home regulator is the portal; an electronic portal or manual portal, however you want to do it, or should it be the commercially most relevant State that is the portal, where the system then becomes invisible to the company in terms of that you go to that portal, whoever it might be; that your product approvals or your product forums, because in New York, we do it on a complete certification process now, without the so-called "prior approval" of the department after a lengthy review, and you can go through that portal, get your products, get your rates, whatever it is that you might want to do, and file it so that the regulator can do the job that the regulator needs to do, and that is to monitor market conduct, which some people have said let us keep that with the States, to monitor financial solvency, which some people have said keep it with the States.

Now, the difficulty with the optional Federal charter is it is going to become an all or nothing proposition, because they want an optional Federal charter for marketplace activities but maybe not for financial standards, maybe not for agent and broker activities, and it is very difficult to divvy that up.

In the banking world, which is the common analogy, it is an all or nothing proposition. You do not have half the bank being regulated by the State managers or the State superintendents and half the bank being regulated by the OCC or the OTS. The fact of the matter is if you go the optional Federal charter, it will be a full bore move to a Federal mechanism. And we think that given what has already been built at the State level and the move toward single portals, we do not think that the optional Federal charter will be necessary, because the same result will be accomplished through a single portal type of approach.

Senator SCHUMER. Mr. Atchinson gets the last word.

Mr. ATCHINSON. My members, 160 companies, roughly 60 percent of the marketplace, some of them are for an optional Federal charter; some of them do not support it. But my organization grew out of some of the issues which Mr. Hunter raised going back 10 or 15 years, when the life insurance industry found it had self-inflicted a fair number of wounds quite publicly, and it was essentially a set of industry leaders who challenged the industry to establish a set of fairly high and rigorous standards and challenge themselves to try to attain those standards.

Effectively, we have a fairly significant component of the industry that, in fact, have made that commitment of resources, of people, and contrary to what some have said, I believe, a national template for those companies that have established within their organization a national template that works for them that then accommodates all of the different State changes.

And certainly, something like that can be modified and be made to be used more broadly. Superintendent Serio talked about the efforts we have made to collaborate with them, and we certainly appreciate that. I think with appropriate safeguards, whether it is a State system or an optional Federal system, you do need to protect to ensure that the standards never fall below an appropriate level.

Senator SCHUMER. And you are arguing that the industry itself, at least the larger companies, would have an interest in keeping those standards high.

Mr. ATCHINSON. Our members are small, medium, and large from all over. And certainly, Mr. Ryan's company has been one of the leaders in both the creation of our organization and throughout it in his organization. But probably 60 percent of our members are small companies spread all over the country, including Alabama, Texas, Florida, and elsewhere.

It is not about size. It is truly about leadership and a commitment of management to doing business the right way. There is that problem of how do you avoid whatever system you are using that race to the bottom, and you need to incentivize both company management with all the appropriate tools to avoid that.

Senator SCHUMER. Thank you, Mr. Chairman.

I want to thank all of you. That was a very interesting and good discussion.

Chairman SHELBY. Mr. Ahart, what, from a practical level, just quickly, what difference does the regulator make for agents such as yourself?

Mr. AHART. It makes a huge difference. First of all, it makes a big difference in licensing; it makes a big difference in the different laws that we have in——

Chairman SHELBY. Would it save a lot of money?

Mr. AHART. Do we save a lot of money?

Chairman SHELBY. Would it save a lot of expense?

Mr. AHART. If we went to one regulator? No, as long as we had uniformity and had the same——

Chairman SHELBY. Okay; uniform standards.

Mr. AHART. Uniformity is the key, right.

Chairman SHELBY. Mr. Hunter, what difference would it make for consumers?

Mr. HUNTER. If you went to one regulator?

Chairman SHELBY. Yes.

Mr. HUNTER. It does not necessarily make any difference. It depends on the quality of the standards.

Chairman SHELBY. Is it the standards or the regulator or both?

Mr. HUNTER. It can be both, too. And obviously, there are some very high standards that are not enforced very well in some States, and there are some low standards where the regulator comes in and is fairly rigorous. The regulator does matter, but you have to have the legal system underneath it that props it up. I have been told by ACLI and others that they want to set up a competition and drive it down to the lowest common denominator. And so that is why I fear that.

Chairman SHELBY. Mr. Counselman, what difference does it make for brokers?

Mr. COUNSELMAN. For brokers, it is important that we have uniformity so that we do not have to refile multiple times, so it is an expense issue primarily.

Chairman SHELBY. Mr. Hunter, Mr. Ryan, both, what unique characteristics of insurance, a product we call insurance, require a different regulatory treatment from that given banks or security firms? What unique characteristics? Mr. Hunter.

Mr. HUNTER. Well, yes, it is a future promise that can occur years in advance sometimes, particularly life insurance, you may be 40 or 50 years out.

Chairman SHELBY. It is a contract, is it not?

Mr. HUNTER. It is a contract, it is a complex contract. A lot of people cannot figure it out, and it may take many years before you find out whether you have a good company or not, because you have to file a claim to find out sometimes. It is very complex pricing systems, incredibly complex pricing systems in property-casualty particularly, that is very dense and very difficult for consumers to figure out. There are a lot of things I think are different.

Chairman SHELBY. Okay; gentlemen, we thank you for—oh, you have got another question? I was thinking that Schumer was going to be the last word. Go ahead, Senator Sununu.

Senator SUNUNU. I am sorry, Mr. Chairman, and I apologize to the panelists for dragging this out more than they would like.

Mr. Ahart, you talked a little bit about the SMART proposal, which in New England, we refer to as the smaht proposal.

[Laughter.]

Could you describe how it would be enforced with States that do not comply?

Mr. AHART. I actually do not think I mentioned the SMART proposal in my oral testimony here, but in being drafted, it looks like there is a partnership being formed between the State and the Federal that would have a board of seven people or so, and they would not have complete authority, but they would be more mediators to try to get it done.

Senator SUNUNU. Neither you nor the organization you are representing today have endorsed or supported that proposal?

Mr. AHART. We are in favor of it being proposed as it is now, yes.

Senator SUNUNU. I do not feel like you actually described an effective enforcement mechanism, though. What is the value if there is not an effective mechanism for bringing States into compliance?

Mr. AHART. Again, I think the process has tried to stay away completely from a Federal regulator; it is to keep State regulation, so the mechanism is to get the bodies involved to be able to mediate it and take care of it that way.

Senator SUNUNU. Mediation.

Mr. AHART. Yes.

Senator SUNUNU. I do not know if that would work or not, but I certainly would not consider mediation to be enforcement.

Mr. AHART. And there always is the court system, as we have now, in different areas.

Senator SUNUNU. So take someone to State court or Federal court?

Mr. AHART. You know, we can give a response. I do not think it has been decided. It depends on where it would come about and what the circumstances of the case would be, just as it is now decided whether it should go to State or Federal court.

Mr. COUNSELMAN. Senator.

Senator SUNUNU. Yes, I will let you respond, because I believe this is an important point, because you heard my opening statement, although maybe you were not listening.

Mr. AHART. No, I did hear it.

Senator SUNUNU. And I certainly appreciate that, and I understand that.

In talking about the value of standards, I do not think it is enough to have a piece of legislation that says we would like to have uniform standards or we will have uniform standards if there is no mechanism for enforcing that, and it is hard for me to look around to find a situation where we have Federal standards but no mechanism for enforcement, and not being a lawyer and being a little bit concerned about the current state of the legal system, to say this will be enforced through the courts is not necessarily something I am comfortable with.

Mr. AHART. Right, but, I mean, I would just say that the mechanism different than now is that there would be Federal law that would make a uniform standard, and there are certainly Federal laws now where there is conflict between State law and Federal law in a gray area, and those things are handled in court now.

Senator SUNUNU. Although oftentimes, at least, in fact, most all the times I can think of, we have some Federal entity that is responsible for enforcement: Telecommunications law, you have the FCC. Securities law, we have the SEC. Federal banking charter, we have the OTS, we have the OCC. Let me let——

Mr. AHART. Let me just say, the ultimate enforcer is the State. I mean, the State would still be the regulatory body.

Senator SUNUNU. So you would have Federal standards and compel the State regulator to enforce the Federal standards.

Mr. AHART. Right, correct, and then, you have this body that would take care of any issues in between. There is the question.

Senator SUNUNU. Okay; I do not know if that is a fair characterization of the proposal.

Mr. Counselman.

Mr. COUNSELMAN. Senator, my understanding of the enforcement mechanism that is currently in the proposal would be the ability or inability of a State to collect nonresident licensing fees and also surplus lines taxes; if they were not in compliance, they would be prevented from collecting those fees and taxes.

Mr. SERIO. Only in certain specific areas.

Senator SUNUNU. Although I do not consider that enforcement, I consider that a monetary threat.

Mr. AHART. Right, correct.

Senator SUNUNU. Sometimes, it can be effective, depending on the nature of the threat and your willingness to follow through with it.

Does anyone want to comment on this specific line of questioning?

Mr. Hunter.

Mr. HUNTER. Yes, it is an unfunded mandate, and I do not see an enforcement mechanism in there. I think you are right.

Senator SUNUNU. While I have you close to the microphone, let me ask you a very quick question: Do you believe that regulatory costs are passed on to consumers?

Mr. HUNTER. Oh, absolutely.

Senator SUNUNU. Excellent.

[Laughter.]

Well, there was an earlier question about the benefit to consumers, and I understand your point that consumers care most about the quality of regulation, but if you believe, as I do, and you may not, that a better set of standards or a streamlined system is less costly, then, that will benefit consumers.

Mr. HUNTER. We pay the costs, and we want an efficient system, but we do not want to lose protections that are necessary.

Senator SUNUNU. I hear you.

Why do I not start this question with you, Mr. Ahart, also, though you may not want to talk about the House proposal. But it does, as I understand it, and I think as you describe it, it would preempt State law. The standards would preempt State law. We talked about the problem with enforcement. But it would seem to me that the disadvantage of this kind of an approach is that in preempting State law, it is at least as intrusive as an optional charter that Senator Schumer was talking about and that I have spoken to a lot of people about.

And I would like you to comment on that, and I would certainly like Mr. Serio to comment on it, too.

Mr. AHART. Sure; I think the difference is the extent that it does that. I think ultimately, if a State was not part of the majority that came up with that model law, they would be forced to comply, so in effect, it would preempt State law on that particular issue.

Where it is different from a Federal charter, optional Federal charter, is that it is just tackling that one issue, where an optional Federal charter is creating a whole new body, and you have dual regulation and a Federal regulator.

Mr. SERIO. As I said in response to Senator Schumer's question, it is going to become an all or nothing proposition. You cannot have the charter hang out there as a license on a company's wall without there being some enforcement mechanism behind it. I think the House bill already anticipates that by creating this confluence of Federal policymaking plus State regulation or State enforcement.

It has been done in other areas before. We think that that is a viable alternative to creating an entirely new structure.

Senator SUNUNU. Has the NAIC endorsed the House proposal, the SMART proposal?

Mr. SERIO. We have not endorsed the bill. We have been in a series of discussions with the House. We have found ourselves in agreement on a wide number of uniformity proposals in it.

Senator SUNUNU. Have your members expressed concern about the fact that it directly preempts States?

Mr. SERIO. Preemption is an issue. The partnership, the preemption, and the rate regulation are the three areas of greatest concern, and we continue to discuss them. I do not think we can say that we are yea or nay on any one of those yet, because we think that the dialogue and discussion is still going on, and it has been a productive dialogue at understanding what the needs of the industry are, and we have heard them, and we have talked about them for a long time, but also what the needs are of the regulators, not so much the regulators as themselves, and I understood your point earlier that we are not supposed to be the ones in the middle of this.

We do not want to be in the middle of a market transaction. But when you have a commodity that is not a price-driven commodity or should not be a price-driven commodity, that is, based upon a future promise, we stand in the role of the monitor to make sure that that contract that is done today is still viable 10 or 20 years from now, particularly in the life insurance area.

Senator SUNUNU. Why shouldn't a life insurance product be a price-driven commodity?

Mr. SERIO. Why should it be or shouldn't it be?

Senator SUNUNU. I think you just said it shouldn't be.

Mr. SERIO. Shouldn't be a price-drive commodity.

Senator SUNUNU. Why do you not think a life insurance policy should not be a price-driven commodity?

Mr. SERIO. Because if it is a price-driven commodity alone, and we advocate to our residents that they need to shop for life insurance and any kind of insurance with price being the last issue.

Service, financial solvency, and market conduct experience or record are far more important issues in the purchase of any life insurance or any insurance product than price. You certainly do not want to be buying something for too high a price.

Senator SUNUNU. I will make sure that this is underlined in the record.

Mr. SERIO. That is how I got this job, that kind of logic.

[Laughter.]

Senator SUNUNU. Let us stipulate for a moment that the State regulators in New York have done their job in effectively regulating and ensuring the safety and soundness of those companies that are domiciled in the State. Provided that, I do not think you have made an argument; I would think that life insurance products, most basic life insurance products; I am sure there are some very sophisticated products; this may not be the case, but whose payout and value are based primarily on interest rates and actuarial tables, they should be price-driven products, where consumers can compare apples-to-apples, find the best-priced product, and in doing so, I am sure they take the service and the personal relationship into effect, but those are effectively commodity products given their very nature.

Mr. SERIO. Price is a factor. Price should not be the leading factor on it. It should be a factor. I will go to this issue. Just a few years ago, we had this thing called vanishing premiums, where people were given a promise that their premiums were going to go away, and they were going to have this insurance coverage forever or for as long as they were told they were going to have it.

That did not pan out, because those interest assumptions were wrong, because those other investment income assumptions were wrong over the duration of that policy. And we had to go back and rethink how it is that the companies are not only structuring these products but how they are selling them. And I think what has been happening is that this notion that the public is going to save money a little bit here, a little bit there is a hard thing to do when you are talking about a product that you need to have guaranteed at the end of the day.

As Art Ryan noted earlier, I know as the ACLI President, Governor Keating, has mentioned on a number of times, we are talking about economic security here. We are not talking about buying a car or a gallon of milk. We are talking about economic security over the long haul, and you will have those disparities in the financial conditions of these companies happen over time.

Senator SUNUNU. And I appreciate that point, but we have had a few hearings on products like mutual funds, pension plans, and 401(k)'s here in this Committee room, all financial products that are regulated by the Federal Government. And the notion that they are regulated by the Federal Government, one, has not created a race to the bottom but I do not think has taken away from any of those important factors.

Mr. Ryan, I did want to hear your comments about the optional charter proposal and the location of the regulator. I think the optional charter proposal that I have seen and discussed with a lot of people would put the regulator in the Department of the Treasury. Could you describe what the value, if there is a value to industry or consumers, would be of doing that?

Mr. RYAN. Yes; as I mentioned in my testimony, by working both tracks to work with the States in improving, as Greg has talked about, and also having available the optional Federal charter; the debate on the location is probably one of the last things that needs to be finalized, but the logic that has been proposed in terms of the Treasury Department really deals with the need for the coordination between banking, securities, and insurance.

As you know, there is a significant overlap. You take a product like a variable annuity, where you overlap between security and insurance. Certainly, there are a number of banking products I could describe that have similar characteristics. And so, the argument is that the Treasury Department has a level of expertise around solvency and related issues.

And without going to say a United Kingdom or a Japanese system, where there is a single regulator over securities, insurance, and banking, the opportunity for coordination would exist greater if it existed within the Treasury or at least provided for that degree of coordination. So, I think the drive is more the coordination, and Treasury certainly could be a reasonable solution to that need for coordination.

Mr. MCCARTNEY. Senator, perhaps the most obvious benefit is that Senator Shelby would have jurisdiction over it.

[Laughter.]

Senator SUNUNU. You brought a smile to the Chairman's face, and that is always a good time to bring a conclusion to the hearing.

So, Mr. Chairman, I want to thank you very much for being indulgent and giving me extra time for a second round of questioning, and thank you very much to our panelists.

Chairman SHELBY. This hearing was supposed to have been a hearing on the state of the industry, but I think it got into a lot of discussion and I think healthy discussion on Senator Sununu would say an optional Federal charter or something to that extent. We thank all of you for your testimony here today, and the hearing is adjourned.

[Whereupon, at 4:40 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and response to written questions supplied for the record follow:]

## PREPARED STATEMENT OF SENATOR WAYNE ALLARD

I would like to thank Chairman Shelby for holding this important hearing today to examine the state of the insurance industry. There are currently a variety of recommendations, proposals, and issues of importance to all sectors of the insurance industry being discussed, and I am pleased to have the opportunity to take a closer look at those today.

The passage of the Gramm-Leach-Bliley Act almost 5 years ago significantly changed the regulation of financial institutions, reaffirming the regulation of insurance by the States as granted by the 1945 McCarran-Ferguson Act.

Recently, much discussion has occurred, and efforts are being made to transfer certain regulatory authority of insurance to the Federal Government. Such a consideration should be approached with caution and deliberation.

Congress must continue to carefully examine the regulatory structure to see that no group is ultimately put at a competitive disadvantage with any changes that may be made to the existing structure.

Terrorism Reinsurance is another area in which Congress must take a deliberation approach. I supported Terrorism Insurance in 2002, understanding that the circumstances were unprecedented, and the threat to the economy grave.

Whether the Act, as a whole, should be extended beyond the end of 2005 will require extensive research as well as deliberation within the Congress. We must determine whether or not this action would be the most appropriate.

Specifically, I will be interested to hear how the commercial insurance industry has taken steps to become less reliant on assistance from the Federal Government.

I look forward to hearing from each of our witnesses today about the progress they are making under the so-called "functional regulatory structure" created by Gramm-Leach-Bliley.

I also look forward to hearing about challenges the insurance industry is facing with particular regard to what barriers the market may not be able to correct without Congressional intervention.

Thank you to each of our witnesses for agreeing to testify today.

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## STATEMENT OF GREGORY SERIO

CHAIR, GOVERNMENT AFFAIRS TASK FORCE
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS AND
SUPERINTENDENT, NEW YORK DEPARTMENT OF INSURANCE

SEPTEMBER 22, 2004

### Introduction

Good morning, my name is Greg Serio. I am the Superintendent of Insurance in New York. This year, I am serving as Chair of the Government Affairs Task Force of the National Association of Insurance Commissioners (NAIC). I am pleased to be here on behalf of the NAIC and its members to provide the Committee on Banking, Housing, and Urban Affairs with an overview of the Nation's State-based system of insurance regulation, as well as an update of our efforts to modernize State insurance supervision to meet the demands of the 21st century.

Today, I would like to make three basic points:

- First, NAIC and the States are well underway in our efforts to modernize State regulation where improvements are needed, while preserving the benefits of local consumer protection that is the real strength of State insurance regulation. With NAIC's adoption in September 2003 of *A Reinforced Commitment: Insurance Regulatory Modernization Action Plan,* State regulators are on time and on target to accomplish changes needed to achieve a more efficient system of State-based national insurance regulation in the United States. In some areas, our goal is to achieve regulatory uniformity nationwide because it makes sense for both consumers and insurers. In areas where different standards among States are justified because they reflect regional market conditions, we are harmonizing State regulatory procedures to facilitate compliance by insurers and agents doing business in those markets.
- Second, insurance is a complex commercial product that is very much different from banking and securities. Consequently, the process for regulating insurance products must also be different. Insurance policies are financial guarantees that are necessarily rooted in the contractual and tort laws of each State to provide protection against unexpected or unavoidable losses that can cripple the lives of individuals, families, and businesses. In doing so, insurance products inevitably

touch a host of important and often controversial social issues that are addressed by specific statutory code language in every State. Current natural disasters, including hurricanes in Alabama and fires in California, highlight the advantages of State insurance oversight. State officials are in the best position to respond quickly, and to fashion remedies that are responsive to local conditions. We are directly accountable to consumers who live in our communities, and are more likely to effectively police claims-handling, underwriting, rating, and marketing practices. In addition, residual market mechanisms, which become important as markets harden after catastrophic losses, are more appropriately designed and administered by State officials familiar with the insurance carriers, geography, and demographics of their region.

- Third, we strongly believe an effective system of national regulation does not mean Federal regulation. Involving the Federal Government will not simplify the complexity of insurance issues, nor diminish their number, nor smooth the process of regulation. Instead, Federal intervention in supervising insurance will simply add additional layers of uncertainty, confusion, and cost for policyholders and claimants regarding "who is in charge" of supervising insurance payments when they are most vulnerable to the stresses of life's disasters and personal losses. Any Federal legislation dealing with insurance regulation carries the risk of undermining State consumer protections through unintended or unnecessary preemption of State laws and regulations. Creating an optional Federal charter and its related regulatory apparatus would have a serious negative impact on the State regulatory system, including our efforts to make improvements in areas sought by proponents of a Federal charter. Ultimately, a Federal regulator would adversely affect State premium taxes and other revenues, which totaled $12.3 billion in 2002.

**State Regulatory Modernization: On Time and On Target**

The State regulatory system is inherently strong when it comes to protecting consumers because we understand local needs and market conditions. However, we agree there is a need to make the system more uniform, reciprocal, and efficient. Consequently, State regulators have agreed upon a specific modernization plan that is now being implemented across the Nation.

In March 2000, insurance commissioners committed to modernizing the State system by unanimously endorsing an action plan entitled *Statement of Intent—The Future of Insurance Regulation.* This important document set forth a common vision of our response to the Gramm-Leach-Bliley Act and how a State-based system of national regulation should develop in each area where modernization is needed. In September 2003, State regulators took the next step in the modernization process by setting specific program targets and a common schedule for implementing them through adoption of the *Reinforced Commitment: Insurance Regulatory Action Plan.* This landmark document—the result of lengthy discussions and negotiations—puts the States on a track to reach all key modernization goals at scheduled dates within the next few years. A copy of the NAIC's *Insurance Regulatory Action Plan,* together with an update of our current implementation progress to September 2004, is attached as ATTACHMENT A * to this statement.

Working in our individual States and collectively through the NAIC, we have made tremendous progress in achieving an efficient regulatory system for the business of insurance. Significantly, our specific regulatory program targets were developed with extensive input from industry and consumer representatives who are active in the NAIC's open committee process. We strongly believe our regulatory action plan satisfies every legitimate complaint regarding inefficiency and redundancy in the State system. Even if an alternative Federal regulatory system were set up tomorrow, there is no way it could achieve these improvements on a schedule that comes close to the aggressive timetable that State regulators have adopted voluntarily.

**Specific Action Goals in the NAIC Plan**

The NAIC's *Insurance Regulatory Action Plan* covers every important area needed to achieve an effective national regulatory system, while still protecting consumers and industry participants in each State:

*Consumer Protection*

"An open process . . . access to information and consumers' views . . . our primary goal is to protect insurance consumers, which we must do proactively and ag-

* Held in Committee files.

gressively, and provide improved access to a competitive and responsive insurance market."

*Market Regulation*

"Market analysis to assess the quality of every insurer's conduct in the marketplace, uniformity, and interstate collaboration . . . the goal of the market regulatory enhancements is to create a common set of standards for a uniform market regulatory oversight program that will include all States."

*Speed-to-Market for Insurance Products*

"Interstate collaboration and filing operational efficiency reforms . . . State insurance commissioners will continue to improve the timeliness and quality of the reviews given to insurers' filings of insurance products and their corresponding advertising and rating systems."

*Producer Licensing*

"Uniformity of forms and process . . . the NAIC's broad, long-term goal is the implementation of a uniform, electronic licensing system for individuals and business entities that sell, solicit, or negotiate insurance."

*Insurance Company Licensing*

"Standardized filing and baseline review procedures . . .the NAIC will continue to work to make the insurance company licensing process for expanding licensure as uniform as appropriate to support a competitive insurance market."

*Solvency Regulation*

"Deference to lead States . . . State insurance regulators have recognized a need to more fully coordinate their regulatory efforts to share information proactively, maximize technological tools, and realize efficiencies in the conduct of solvency monitoring."

*Change In Insurance Company Control*

"Streamline the process for approval of mergers and other changes of control."

NAIC members understand these goals present difficult challenges. However, with the active support and participation of governors and State legislators, as well as industry and consumer advocates, we are confident NAIC member States will achieve these goals.

**Insurance is a Complex Financial Product that Demands Local Regulation**

Paying for insurance products is one of the largest consumer expenditures of any kind for most Americans. Figures compiled by the NAIC show that an average family can easily spend a combined total of $4,500 each year for auto, home, life, and health insurance coverage. This substantial expenditure—often required by law or business practice—is typically much higher for families with several members, more than one car, or additional property to insure. Consumers clearly have an enormous financial and emotional stake in making sure insurers keep the promises they make.

Protecting insurance consumers in a world of hybrid institutions and products must start with a basic understanding that insurance is a different business than banking and securities. Banks make loans based upon a straight-forward analysis of a customer's collateral and ability to pay, whereas securities can be bought by anyone having sufficient funds at a price set by open markets. In contrast, insurance is a commercial product that offers consumers a financial guarantee that takes into account each customer's potential claims for losses (depending on variable circumstances), financial situation, place of residence, type of business, "risk management" preparations, or lifestyle choices such as smoking, exercise, education, and travel.

Insurance is thus based upon series of individual subjective business decisions such as these: Will an insurance policy be offered to a consumer? At what price? What are the policy terms and conditions? Is a claim filed by a policyholder valid? If so, how much should the customer be paid under the policy terms? All of these subjective business decisions add up to one absolute certainty: Insurance products can generate a high level of consumer backlash and customer dissatisfaction that requires a higher level of regulatory resources and responsiveness.

As regulators of insurance, State governments are responsible for making sure the expectations of American consumers—including those who are elderly or low income—are met regarding financial safety and fair treatment by insurers. Nationwide in 2002, State insurance departments employed more than 13,000 regulatory personnel and spent $947 million to be the watchful eyes and helping hands on insurance problems. We helped consumers collect tens of millions of dollars in claims payments.

The States also maintain a system of financial guaranty funds that cover personal losses of consumers in the event of an insurer insolvency. It is important for Congress to note that the entire State insurance system is authorized, funded, and operated at absolutely *no cost* to the Federal Government.

There have been charges from some industry groups that the State regulatory system is inefficient and burdensome, and that a single Federal regulator would be better. However, the NAIC and its members do not believe the consumers we serve each day think we are inefficient or burdensome when compared to the agencies and departments of the Federal Government. During 2002, we handled approximately 4.2 million consumer inquiries and complaints regarding the content of their policies and their treatment by insurance companies and agents. Many of those calls were resolved successfully at little or no cost to the consumer.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each State. There is no way the Federal Government could possibly replicate the specific expertise of State legislatures, regulators, and courts to successfully interpret the contractual and tort laws of 50 States and the District of Columbia. Moreover, there is no reason for the Federal Government to do so when the States have a specific modernization plan and timetable to get the job done.

**Congress Must Not Undermine State Modernization Efforts**

The NAIC and its members believe Congress must be very careful in considering potential Federal legislation to achieve modernization of insurance regulation in the United States. Even well-intended and seemingly benign Federal legislation can have a substantial adverse impact on existing State laws and regulations designed to protect insurance consumers. Because Federal law preempts conflicting State laws under the U.S. Constitution, hastily drafted or vague Federal laws can easily undermine or negate important State legal protections for American consumers.

When Congress passed the Gramm-Leach-Bliley Act (GLBA) in 1999, it acknowledged once again that States should regulate the business of insurance in the United States, as set forth originally in the McCarran-Ferguson Act. There was a careful statutory balancing of regulatory responsibilities among Federal banking and securities agencies and State insurance departments, with the result that Federal agencies would not be involved in making regulatory determinations about insurance matters.

Even though Congress tried very hard in GLBA to craft language that would not unnecessarily preempt State laws, there have already been disagreements about the extent to which federally chartered banks may conduct insurance-related activities without complying with State laws. Under GLBA, no State law may "prevent or significantly interfere" with the ability of a federally chartered bank to conduct insurance-related business permitted by GLBA. federally chartered banks have aggressively asserted their perceived rights under GLBA to conduct nonbanking business unhindered by State laws. As a result, the entry of federally chartered banks into insurance has become a source of uncertainty and dispute despite the best efforts of Congress to avoid this very result.

We fully expect federally chartered insurers would insist that State laws involving solvency and market conduct cannot "prevent or significantly interfere" with their federally granted powers to conduct insurance business anywhere in the United States. A Federal insurance charter with its associated laws, regulations, and bureaucracy must necessarily parallel every aspect of existing State laws and regulations, meaning potential conflicts between State and Federal laws will likely occur across the board. The result would be years of protracted, costly litigation, as well as market and regulatory confusion that will benefit the legal community rather than insurance providers and consumers.

One of the great strengths of State insurance regulation is the fact it is rooted in other State laws that apply when insurable events occur. The NAIC urges Congress to avoid undercutting State authority in considering any Federal legislation that would preempt important consumer protections or create a Federal insurance charter. Federal laws that appear simple on their face can have devastating consequences for State insurance departments trying to protect the public.

**The Impact of Federal Chartering on State Regulation Will Not Be "Optional"**

Some industry representatives have said a Federal charter merely adds an optional choice to the insurance regulatory system in the United States, and that it would not seriously affect the existing State system. State regulators disagree with this assertion. A Federal charter may be optional for an insurer choosing it, but the negative impact of federally regulated insurers will not be optional for consumers, producers, State-chartered insurers, State governments, and local taxpayers who are affected, even though they have little or no say in the choice of a Federal charter.

Let us be clear about the impact of a Federal insurance regulator upon State regulation and our ability to protect consumers: *The Federal Government is not an equal regulatory partner because it can preempt State laws and regulations.* This simple fact contradicts the very foundation of insurance in the United States; because

insurance products are uniquely intertwined and dependent upon State law for everything from underwriting standards, to pricing, to claims procedures, to legal resolution of disputes. There is no logical or practical way to divorce insurance regulation from the State laws that give rise to consumer insurance products.

Despite our different sizes, geography, and market needs, States work together through the NAIC as legal equals under the present system. We find solutions as a peer group through extensive discussion and debate, give-and-take and mutual respect, knowing that no single State can force its own will over the valid concerns and objections of other States. Keeping in mind the original purpose of regulation is to protect all consumers, we believe this participatory democracy and State decisionmaking, based upon the political and business realities of local markets, is a major strength of the State-based system for protecting consumers and regulating insurers and agents.

Ultimately, a Federal charter and its regulatory system would result in at least two separate insurance systems operating in each State. One would be the current department of insurance established and operated under State law and government supervision. This system will continue responding directly to State voters and taxpayers, including the statewide election of the insurance commissioner in twelve States.

A second system would be a new Federal regulator with zero experience or grounding in the local State laws that control the content of insurance policies, claims procedures, contracts, and legal rights of citizens in tort litigation. Nonetheless, this new Federal regulator would undoubtedly have the power to preempt State laws and authorities that disagree with the laws that govern policyholders and claimants of State-chartered insurers. At the very least, this situation will lead to consumer, market, and regulatory overlap and confusion. At worst, it will lead to varying levels of consumer protection, perhaps even a "race to the bottom" to lower consumer protection standards, based upon whether an insurer is chartered by Federal or State government.

Granting a Government charter for an insurer means taking full responsibility for the consequences, including the costs of insolvencies and consumer complaints. The States have fully accepted these responsibilities by covering all facets of insurance licensing, solvency monitoring, market conduct, and handling of insolvent insurers. The NAIC does not believe Congress will have the luxury of granting insurer business licenses without also being drawn into the full range of responsibilities and hard-hitting criticism—fair and unfair—that go hand-in-hand with a Government charter to underwrite and sell insurance. Furthermore, we doubt States will be willing to accept responsibility for the mistakes or inaction of a Federal regulator by including Federal insurers under State guaranty funds and other important, proven consumer protection laws.

**Conclusion**

The system of State insurance regulation in the United States has worked well for 125 years. State regulators understand that protecting America's insurance consumers is our first responsibility. We also understand commercial insurance markets have changed, and that modernization of State insurance standards and procedures is needed to facilitate less costly and less burdensome regulatory compliance for insurers and producers.

We respectfully request that Congress, consumers, and insurance industry participants work with us to implement the specific improvements set forth in the NAIC's *Insurance Regulatory Modernization Action Plan* through the State legislative system. This is the only practical, workable way to achieve necessary changes quickly in a manner that preserves the State consumer protections consumers demand. The State-based regulatory reform approach far exceeds having an "insurance czar" in Washington, DC, along with the huge, costly, isolated Federal bureaucracy that will accompany it. It also gives citizens in each State control over important aspects of insurance and claims procedures that affect their financial security in the communities where they live.

The NAIC and its member States have fully cooperated over the years with important inquiries by Congress into the adequacy of the State regulatory system. We believe these inquiries have been productive, and have clearly demonstrated why local and regional State regulation of insurance is the very best way to meet the demands of consumers for this unique financial product. We will continue to work with Congress and within State government to improve the national efficiency of State insurance regulation, while at the same time preserving our longstanding, proven, and successful dedication to protecting American consumers.

Insurance regulatory modernization and protection of insurance consumers are not, nor should they ever be, mutually exclusive notions. We can achieve both these important objectives.

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## STATEMENT OF ARTHUR F. RYAN

CHAIRMAN, AMERICAN COUNCIL OF LIFE INSURERS AND

CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PRUDENTIAL FINANCIAL

SEPTEMBER 22, 2004

Chairman Shelby, Senator Sarbanes, and Members of the Committee, it is an honor to represent the over one million individuals working in the life insurance industry in America. I am here today not only as Chairman and Chief Executive Officer of Prudential Financial—one of the world's largest diversified life insurance companies—but also as the Chairman of the American Council of Life Insurers (ACLI). With 368 members, the ACLI is the principal trade association representing domestic life insurance companies.

Today, I will discuss:

- The function of life insurers in the marketplace and in the economy;
- Our industry's role in helping baby boomers and others provide for their retirement security and financial needs; and
- Why regulatory changes are important to the insurance industry and what the ACLI has done to assess the current regulatory environment and identify areas that are in need of improvement.

Today, the life insurance industry competes in a national and even global marketplace. We have entered the 21st century as a much more involved, dynamic partner with American families and businesses, assisting them in protecting and growing their wealth. We provide financial security for Americans in all stages of life with products like life insurance, annuities, disability, and long-term care insurance.

These products not only protect a family's finances, but also enable Americans to save money, accumulate wealth for retirement and convert it into a lifetime stream of guaranteed retirement income.

No other financial intermediary can do that. The life insurance business is a vital component of the U.S. economy, providing a wide array of essential financial and retirement security products and services to all segments of the American public.

Currently there are over 395 million life insurance policies in force, providing Americans with $17 trillion in financial protection. In addition, Americans have saved $2 trillion toward their retirement by investing through our annuity products. Our long-term commitments and investments have placed us as one of the largest investors in the U.S. economy assisting in economic growth. In managing these obligations, the industry has invested $3.4 trillion in the financial markets, representing 9 percent of the total capital. Life insurers are one of the largest holders of long-term, fixed-rate commercial mortgages in the United States. These long-term, financial commitments are generally 10 years and longer in maturity, much longer than commitments made by other industries.

Our most recent numbers show that life insurers invested more than $304 billion in new net funds in the Nation's economy. Fifty-seven percent of the industry's assets—or $2 trillion—are held in long-term bonds, mortgages, real estate, and other long-term investments. This includes:

- $417 billion invested in Federal, State, and local government bonds, helping to fund urban revitalization, public housing, hospitals, schools, airports, roads, and bridges;
- $251 billion invested in mortgage loans on real estate-financing for homes, family farms, and offices;
- $1.2 trillion invested in long-term U.S. corporate bonds; and
- $791 billion invested in corporate stocks.

Notwithstanding the massive investment we make in the economy, it is the area of long-term savings and retirement security where the life insurance industry may have the greatest positive impact on public policy in the coming years. With 76 million baby-boomers nearing retirement, the United States faces a potential retirement crisis. We must confront the fact that the average American nearing retirement has only $47,000 in savings and assets, not including real estate. Industry research indicates that 68 percent of Americans believe they will not be able to save enough for retirement.

Future retirees will have fewer sources of guaranteed income than previous generations. This is due to the decline of traditional defined benefit pension plans and the fact that Social Security, on average, replaces only 42 percent of earnings. If nothing is done, there is a real possibility that millions of Americans will outlive their retirement assets.

The insurance industry is dedicated and uniquely positioned to help American workers prepare for their financial futures with life insurance, long-term care, retirement and annuity products. Our industry continues to be a prominent resource in helping both large and small employers provide the right qualified retirement or savings plan for their employees. Insurers act as asset managers and/or administrators for defined benefit, 401(k), 403(b), 457 plans, and other tax-qualified arrangements.

The industry also enables individuals to take control of their own long-term savings through the purchase of annuities. Annuities offer the critically important guarantee of a steady income stream for an individual's lifetime. Although no single savings vehicle by itself can address the retirement savings crisis, the insurance industry is positioned to offer your constituents and all Americans an array of product choices to meet their retirement security needs.

However, for the insurance business to remain viable and serve the needs of the American public effectively, our system of life insurance regulation must become far more efficient and responsive to the needs and circumstances of a 21st century global business.

Life insurers today operate under a patchwork system of State laws and regulations that lack uniformity and is applied and interpreted differently from State-to-State. The result is a system characterized by delays and unnecessary expenses that hinder companies and disadvantage their customers. We believe it is appropriate, and we are asking for your help, to modernize our regulatory structure to ensure we are able to continue to serve our customers in the most efficient and effective way.

Any solution must ensure:

- greater speed-to-market for our products;
- uniformity in agent licensing; and
- efficient market conduct examinations.

To achieve that, and in keeping with a policy position adopted by its Board of Directors and embraced by its membership, the ACLI has been addressing regulatory reform on two tracks. Under the first track, the ACLI is working with the States to improve the State-based system of insurance regulation. Under the second, the ACLI is beginning to work with Congress toward a federally oriented solution, which we believe can ultimately best be achieved through an optional Federal charter.

Mr. Chairman, the ACLI is ready to work with this Committee to put in place an appropriate Federal regulatory option available to insurance companies, agencies, and its producers. It is in the best interests of our industry, your constituents, and our overall economy to do so as quickly as possible. Gramm-Leach-Bliley and an increasingly diversified financial services landscape have intensified this need. With your help, the life insurance industry will be able to help American families and businesses meet their financial needs today and beyond.

On behalf of the member companies of the American Council of Life Insurers, I would like to conclude by thanking you and Members of the Committee for the opportunity to express our views on this most important subject.

## PREPARED STATEMENT OF WILLIAM H. MCCARTNEY

SENIOR VICE PRESIDENT, GOVERNMENT AND INDUSTRY RELATIONS, USAA GROUP
ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

SEPTEMBER 22, 2004

Thank you, Chairman Shelby, Ranking Member Sarbanes, and members of the Committee. My name is Bill McCartney, and I am Senior Vice President, Government and Industry Relations at the United Services Automobile Association (USAA)

Group, a national, highly competitive, and fully integrated financial services company headquartered in San Antonio, Texas. USAA and its 22,000 employees provide insurance, banking, and investment products to more than 5 million current and former members of the U.S. military and their families. In fact, USAA's mission, to which we devote our full attention, is "to facilitate the financial security of our members, associates, and their families through provision of a full range of highly competitive financial products and services." The company's net worth is greater than $9 billion and USAA owns or manages assets exceeding $79 billion. USAA is known for its financial strength and outstanding service to its members, and is one of only three property-casualty insurance companies in the Nation to maintain the highest possible ratings from all three major ratings agencies.

I am here to testify today on behalf of USAA and our property-casualty insurance trade association, the American Insurance Association (AIA), and its 450 members. The Committee is addressing an issue that is vitally important to USAA and to AIA: The outdated and dysfunctional nature of today's State insurance regulatory system. It is the firm belief of USAA and AIA's other member companies that State-based regulation does not allow the insurance industry to meet the needs of Americans or the businesses they run.

As a national diversified financial services institution whose members are mobile and may be ordered to change residences frequently, USAA meets its members' insurance needs while navigating our way through the burdensome, inconsistent, and often overlapping web of insurance regulatory standards. This is not an easy task, due primarily to the trifecta of regulatory failure that largely defines State insurance regulation today: (1) lack of regulatory uniformity; (2) pervasive government price controls; and (3) entrenched government product controls.

I speak about the States' regulatory shortcomings from "inside" experience. From 1987 to 1994, I spent 7 years as Nebraska's Director of Insurance and was privileged to serve as President of the National Association of Insurance Commissioners (NAIC) in 1992. I have always believed that the justification for regulatory oversight of insurance rates was to make certain that they are not imperiling an insurer's solvency—the primary and overarching role of insurance regulation. And I used to believe that the States could achieve uniformity and consistency of regulation without Federal intervention. But, over the course of my 30-year career in insurance, I have come to know that the existing regulatory approach at the State level is misguided, that the system of price and product controls empowers regulators, not consumers, that uniformity and consistency are not possible without Federal intervention, and that continuing the current system will drive companies out of business and capital out of the United States.

Let me take a few minutes to address these regulatory problem areas. Lack of uniformity and inconsistency are hallmarks of the State insurance regulatory system. The mere existence of different State regulators presents a significant problem for any company serving a national and highly mobile population. This problem is compounded by the fact that, 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 around the country 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. It is illogical to believe that compliance with more than 500 filing and review requirements will lead to efficiency or consistency.

USAA has long had a compact with our active duty members: We will insure their families' special needs wherever they are assigned. As a result, USAA now serves 54 distinct U.S. insurance regulatory jurisdictions: 50 States, the District of Columbia, and 3 U.S. territories. This translates into at least 54 separate regulatory structures to navigate. Each departure from uniformity and consistency means higher compliance and system costs for USAA. And, as a member-owned association, our policyholders absorb every penny in costs we incur responding to each State's different process.

It is also clear that the current system cannot accommodate modern methods of conducting business locally, regionally, nationally, or internationally. Today, USAA members depend heavily on the Internet, telephones, fax machines, and other electronic means to stay in touch with their families and to conduct personal business. USAA is a pioneer in leveraging information technology to provide the best possible customer service at the lowest cost. But the patchwork of shifting and burdensome State laws means our members are unable to manage their insurance products online at our website to the degree they can administer their other USAA financial products. It is sometimes a Herculean effort just to ensure that our members are speaking and working with only those insurance member service representatives holding licenses in a specific State—a situation we do not face when servicing brokerage, banking, or mutual fund accounts for a member.

The NAIC's efforts, while well-intentioned, can only go so far to produce uniformity and consistency of regulation. The NAIC can draft and adopt models, but it 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 compel other State insurance regulators to push for similar change.

The history of post-McCarran-Ferguson Act State insurance regulation demonstrates that structural change is not a normal occurrence, but an aberration. The Gramm-Leach-Bliley Act of 1999 (GLBA) provides a great example of the States' resistance to structural change, even where Congress provides a significant push. While GLBA established Federal privacy standards for insurance companies with implementation left to the States, 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, while Congress recently reaffirmed Federal preemption of State restrictions on information sharing among affiliated financial institutions, California has continued to defend Senate Bill 1, which flies in the face of Federal law by imposing affiliate-sharing restrictions. This is not only burdensome to insurance companies, but is also confusing to consumers who receive multiple privacy notices.

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 nonresident license is granted. For companies like USAA that only write personal lines insurance and distribute insurance products directly, this means that GLBA's best efforts have not only been for naught, but have resulted in additional burdens.

Many States have failed to be effective regulatory stewards of insurance. The McCarran-Ferguson Act is not a Federal abdication of regulatory oversight responsibility, it is a delegation. Congress can—and should—act to remedy the lack of uniformity and consistency of insurance regulation that is so evident at the State level.

While nonuniformity is an inherent aspect of State insurance regulation, government price and product controls are not. No other competitive industry in the United States is forced to submit their products and the prices charged for those products to a government official for review and approval. This is anathema to the free market environment that forms the backbone of the U.S. economy, including every other competitive industry deemed vital to American citizens, such as food, housing, transportation, and energy. Price and product controls are historical artifacts that have lost their utility and have turned a competitive marketplace into one where insurance prices and products are political pawns. Insurers should not be forced to "beg the government" in order to use their existing products, bring new products to market, or establish prices for those products. Likewise, consumer empowerment in the marketplace should not be replaced by needless regulatory control.

Perpetuation of government price and product controls in insurance has led to a number of problems. First, an entrenched State focus on government price and product controls discourages product innovation and competition, ultimately denying consumers choice. The current regulatory system concentrates on the wrong things. While artificially or arbitrarily repressing prices may be politically popular, it is ultimately economically unwise. Such price controls mask real problems and over a period of time can lead to a crisis, forcing sizable subsidized residual markets and market withdrawals that exacerbate these problems. 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, rates are more politicized, consumer choices are restricted, residual markets are larger, and the number of competing insurers is lower. These elements conspire to drive capital from insurance markets in these States, and place a burden on those insurers that remain.

Similar problems arise from suppression of insurance products. Where regulators do not allow a variety of product options and artificially limit the ability of insurers and consumers to structure their insurance needs, insurers are left with a stark choice between insuring or not insuring a consumer, and consumers may therefore be left without coverage. In contrast, allowing insurers and consumers maximum flexibility in the marketplace provides the best opportunity to limit availability problems.

USAA is not immune from the problems attendant to government price and product controls. In an increasing number of our regulatory jurisdictions, USAA is actually prevented from charging rates commensurate with the risks we insure. We have to submit policy and product forms to regulators for lengthy review before using them in the marketplace. In many States, regulatory rate and form approval delays are chronic and increasing. USAA's federally regulated financial services companies have no similar regulatory obstacles to getting rates and products to market quickly. The emphasis on such controls in insurance slows products from entering the market and inhibits product creativity.

Second, while the property-casualty insurance industry stands out as one of the most heavily regulated sectors of the U.S. economy, it is not just a question of regulation. It is the fact of misguided regulation. If the insurance industry cannot keep pace and cannot provide consumers with real choices, the economy suffers. Insurance provides much-needed security for businesses and individuals to innovate, invest, and take on risk. Yet the ability to innovate, invest, and take on risk is substantially impeded because insurers labor under the weight of a "government-first, market-second" regulatory system. This system rewards inefficient market behavior, subsidizes high risks and masks underlying problems that lead to rising insurance costs. The bottom line is that consumers ultimately will pay more for less adequate risk protection than would be the case under a more dynamic, market-oriented regulatory system.

Third, because regulatory attention at the State level is misguided and resources misdirected to "front-end" price and product regulation, core functions like financial solvency have taken a backseat. This is both unfortunate and dangerous, as it provides little confidence to insurance consumers that their insurance companies will be around and able to pay claims when they arise. This is a vitally important role for insurance regulators, as financially sound insurers lead to a healthy and vibrant market. But there have been some recent lapses at the State level on that front. It is time to take a hard look at these lapses, and to ask hard questions about whether the State regulatory system has elevated outdated and unnecessary elements of regulation to the detriment of industry financial condition.

Whether the problems are inherent in 50-State oversight or are part of the post-McCarran-Ferguson approach to insurance regulation, the current system is undeniably broken and all stakeholders are suffering as a result. As price and product obstacles increase, insurers find it more difficult to compete and make a reasonable profit in the marketplace. This leads to more competitors withdrawing from the market, taking capital and jobs from that market and leaving fewer choices for consumers. It is no surprise that property-casualty insurance consistently has the lowest return on equity of all the financial services industries. The net result is a parochial regulatory environment that encourages inefficiency and repels investors.

The inability to serve customers because of a troubled regulatory system is of acute concern to USAA, as we have a commitment to provide insurance to members wherever they are located. Our mission does not vary with a member's zip code. Unlike other insurers that have the ability to defensively withdraw from markets due to a difficult regulatory environment, USAA's commitment to its members does not make this possible. The current "heavy-handed" regulatory system in many States does not protect consumers, it actually disenfranchises them. Because of the emphasis on price and product controls in these jurisdictions, USAA is forced to devote enormous resources responding to these "pre-market" obstacles rather than developing innovative new products for our members. The system, in fact, discourages innovation because the timeline for approving new products offered nationally can be longer than the shelf-life of the innovation.

The rest of the USAA financial services family does not face these regulatory obstacles. This is confusing and frustrating for our members, who often need to use technology to access our products and services. For example, whenever our members are transferred to another location, they can provide their change of address at our website for all USAA financial services. But, for our property-casualty insurance products, the member's change of address is the beginning, not the end. This is archaic. We should not have a mid-20th century system to handle 21st century needs.

While the focus of this hearing is on the State insurance regulatory environment, USAA and other like-minded companies at AIA have given a lot of thought to solutions to the current problems we are experiencing. After much deliberation, USAA believes that a market-based optional Federal charter would be the best route to true regulatory reform. The optional Federal charter eliminates the arcane government price and product controls that have been so corrosive to the State regulatory system, empowering consumers through marketplace competition. The optional Federal charter also provides for uniform national oversight of federally licensed insurers.

Equally important, the optional Federal charter is just that—a choice. Insurance companies that are comfortable with the current State regulatory system are not forced into the new system, while insurers like USAA that prize uniformity and market freedom may elect to be subject to Federal oversight. Similarly, consumers who are comfortable doing business with State-regulated insurers are free to continue to do so. This is not a new regulatory paradigm, but one that is based on the chartering system for U.S. banks.

Our preferred solution also does not place the Federal Government in unfamiliar regulatory territory. There are numerous examples of Federal involvement in property-casualty insurance. One that immediately jumps to mind is terrorism risk insurance, where the Terrorism Risk Insurance Act of 2002 (TRIA) provides a Federal-private "shared loss" program for terrorism risk that is administered by the U.S. Treasury. While the TRIA program expires in 2005, insurers, policyholders, regulators, and legislators are currently calling for a 2-year extension in order to gather all necessary data about the risk, and for stakeholders to jointly develop and implement a long-term, public-private solution for managing terrorism exposure.

Finally, I would be remiss if I did not applaud the House Financial Services Committee for its unyielding efforts to address the problems I've outlined for the Committee today. Over the past few years, the House has conducted 15 hearings on State insurance regulation in a relentless drive to uncover the ills that plague the State regulatory system. While enactment of the optional Federal charter is our aim, we support the House process, as well as the market-driven direction of the legislative draft that has been widely circulated. In particular, the draft takes an historic "free market" approach to insurance rates, recognizing the negative legacy of State government price controls. We look forward to continuing to work constructively with both the House and the Senate to ensure that the flaws of State insurance regulation are exposed, and Federal legislative solutions found.

Mr. Chairman, thank you for the opportunity to testify and I look forward to answering any questions.

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## PREPARED STATEMENT OF J. ROBERT HUNTER

DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

SEPTEMBER 22, 2004

Mr. Chairman and Members of the Committee, thank you for your invitation to testify today. America's insurance consumers, including small businesses, are vitally interested in how insurance will be regulated in the future. Therefore, your hearing is most timely. We especially appreciate the fact that the Committee is beginning its review with an overall examination of insurance regulation—why it exists, what are its successes and failures—rather than solely reviewing proposed legislation, such as the Oxley-Baker proposal or the optional Federal charter approach.[1] In order to identify whether Federal legislation is necessary and what should be its focus, it obviously makes a great deal of sense for the Committee to first conduct a thorough assessment of the current situation. If the "problem" is not properly diagnosed, the "solutions" that Congress enacts will be flawed.

### Why is Regulation of Insurance Necessary?

The rationale behind insurance regulation is to promote beneficial competition and prevent destructive or harmful competition in various areas.

*Insolvency:* One of the reasons for regulation is to prevent competition that routinely causes insurers to go out of business, leaving consumers unable to collect on claims. Insolvency regulation has historically been a primary focus of insurance regulation. After several insolvencies in the 1980's, State regulators and the National Association of Insurance Commissioners (NAIC) enacted risk-based capital standards and implemented an accreditation program to help identify and prevent future insolvencies. As far fewer insolvencies occurred in the 1990's, State regulators appear to be doing a better job.

*Unfair and Deceptive Policies and Practices:* Insurance policies, unlike most other consumer products or services, are contracts that promise to make certain payments under certain conditions at some point in the future. (Please see the fact sheet on why insurance is different from many other products for regulatory purposes that

[1] CFA strongly opposes both of these proposals as undermining needed consumer protections.

follows the attached September 9, 2004 letter.)* Consumers can easily research the price, quality, and features of a television, but they have very limited ability to do so on insurance policies. Because of the complicated nature of insurance policies, consumers rely on the representations of the seller/agent to a far greater extent than for other products. Regulation exists to prevent competition that fosters the sale of unfair and deceptive policies, sales and claims practices.

Unfortunately, States have not fared as well in this area. Rather than acting to uncover abuses and instigate enforcement actions, States have often reacted after lawsuits or news stories brought bad practices to light. For example, the common perception among regulators that "fly-by-night" insurance companies were primarily responsible for deceptive and misleading practices was shattered in the late 1980's and early 1990's by widespread allegations of such practices by household names such as MetLife, John Hancock, and Prudential. For instance, MetLife sold plain whole life policies to nurses as "retirement plans," and Prudential unilaterally replaced many customers' whole life policies with policies that did not offer as much coverage. Though it is true that State regulators eventually took action through coordinated settlements, the allegations were first raised in private litigation; many consumers were defrauded before regulators acted.

One of the problems insurance departments face is a lack of resources for market conduct regulation. CFA's surveys indicate it would take 5 to 7 years alone for States to complete market conduct exams of just domestic insurance companies and over 50 years for all companies. States making up 75 percent of the country's population have inadequate resources. It is not surprising that many harmful practices fall through the cracks.

*Insurance Availability:* Some insurance is mandated by law or required to complete financial transactions, such as mortgage loans. In a normal competitive market, participants compete by attempting to sell to all consumers seeking the product. However, in the insurance market, participants compete by attempting to "select" only the most profitable consumers. This selection competition leads to availability problems and redlining.[2] Regulation exists to limit destructive selection competition that harms consumers and society.

Lawsuits brought by fair housing groups and the Department of Housing and Urban Development (HUD) have revealed that insurance availability problems and unfair discrimination exist and demonstrate a lack of oversight and attention by many of the States. NAIC had ample opportunity after its own studies indicated that these problems existed to move to protect consumers. It retreated, however, when the insurers threatened to cut off funding for its insurance information database, a primary source of NAIC income.

One obvious solution to discrimination and availability problems is to require insurers to disclose information about policies written by zip code, and about specific underwriting guidelines that are used to determine eligibility and rates. Such disclosure would promote competition and benefit consumers; but State regulators, for the most part, have refused to require such disclosure in the face of adamant opposition from the industry. Regulators apparently agree with insurers that such information is a "trade secret" despite the absence of legal support for such a position. In addition, though insurance companies compete with banks that must meet data disclosure and lending requirements in underserved communities under the Community

* Held in Committee files.

[2] The industry's reliance on selection competition can have negative impacts on consumers. Insurance is a risk spreading mechanism. Insurance aggregates consumers' premiums into a common fund from which claims are paid. Insurance is a contractual social arrangement, subject to regulation by the States.

The common fund in which wealth is shifted from those without losses (claims) to those with losses (claims) is the reason that the contribution of insurance companies to the Gross National Product of the United States is measured as premiums less losses for the property/casualty lines of insurance. The U.S. Government recognizes that the losses are paid from a common fund and thus are a shift in dollars from consumers without claims to those with claims, not a "product" of the insurance companies.

Competition among insurers should be focused where it has positive effects, for example, creating efficiencies, lowering overhead. But rather than competing on the basis of the expense and profit components of rates, the industry has relied more on selection competition, which merely pushes claims from insurer to insurer or back on the person or the State. States have failed to control against the worst ravages of selection competition (for example redlining).

Some of the vices of selection competition that need to be addressed include zip code or other territorial selection; the potential for genetic profile selection; income (or more precisely credit report) selection; and selection based on employment. Targeted marketing based solely on information such as income, habits, and preferences leaves out consumers in need of insurance, perhaps unfairly.

Reinvestment Act (CRA), insurers refuse to acknowledge a similar responsibility to communities.

*Reverse Competition:* In certain lines of insurance, insurers market their policies to a third party, such as creditors or auto dealers, who, in turn, sell the insurance to consumers on behalf of the insurer for commission and other compensation. This compensation is often not disclosed to the consumer. Absent regulation, reverse competition leads to higher—not lower—prices for consumers because insurers "compete" to offer greater compensation to third party sellers, driving up the price to consumers.

The credit insurance market offers a perfect example of reverse competition. Every few years, consumer groups issue reports about the millions of dollars that consumers are overcharged for credit insurance. Despite the overwhelming evidence that insurers do not meet targeted loss ratios in most States, many regulators have not acted to protect consumers by lowering rates.

The markets for low value life insurance and industrial life insurance are characterized by overpriced and inappropriately sold policies and a lack of competition. This demonstrates the need for standards that ensure substantial policy value and clear disclosure. Insurers rely on consumers' lack of sophistication to sell these overpriced policies. With some exceptions, States have not enacted standards that ensure value or provide timely, accurate disclosure. Consumers continue to pay far too much for very little coverage.

*Information for Consumers:* True competition can only exist when purchasers are fully aware of the costs and benefits of the products and services they purchase. Because of the nature of insurance policies and pricing, consumers have had relatively little information about the quality and comparative cost of insurance policies. Regulation is needed to ensure that consumers have access to information that is necessary to make informed insurance purchase decisions and to compare prices.

While information and outreach efforts of States have improved, States and the NAIC have a long way to go. Some States have succeeded in getting good information out to consumers, but all too often the marketplace and insurance regulators have failed to ensure adequate disclosure. Their failure affects the pocketbooks of consumers, who cannot compare adequately on the basis of price.

In many cases, insurers have stymied proposals for effective disclosure. For decades, consumer advocates pressed for more meaningful disclosure of life insurance policies, including rate of return disclosure, which would give consumers a simple way to determine the value of a cash-value policy. Today, even insurance experts cannot determine which policy is better without running the underlying information through a computer. Regulators resisted this kind of disclosure until the insurance scandals of the 1990's involving widespread misleading and abusive practices by insurers and agents prompted States and the NAIC to develop model laws to address these problems. Regulators voiced strong concerns and promised tough action to correct these abuses. While early drafts held promise and included some meaningful cost-comparison requirements, the insurance industry successfully lobbied against the most important provisions of these proposals that would have made comparison-shopping possible for normal consumers. The model disclosure law that NAIC eventually adopted is inadequate for consumers trying to understand the structure and actual costs of policies.

California adopted a rate of return disclosure rule a few years ago for life insurance (similar to an APR in loan contracts) that would have spurred competition and helped consumers comparison-shop. Before consumers had a chance to become familiar with the disclosures, however, the life insurance lobby persuaded the California legislature to scuttle it.

**Are the Reasons for Insurance Regulation Still Valid?**

The reasons for effective regulation of insurance are as relevant, or in some instances even more relevant, today than 5 or 10 years ago:

- Advances in technology now provide insurers access to extraordinarily detailed data about individual customers and allow them to pursue selection competition to an extent unimaginable 10 years ago.
- Insurance is being used by more Americans not just to protect against future risk, but as a tool to finance an increasing share of their future income, for example, through annuities.
- Increased competition from other financial sectors (such as banking) for the same customers could serve as an incentive for misleading and deceptive practices and market segmentation, leaving some consumers without access to the best policies and rates. If an insurer cannot compete on price with a more efficient competitor, one way to keep prices low is by offering weaker policy benefits (that is, "competition" in the fine print).

- States and lenders still require the purchase of auto and home insurance. Combining insurer and lender functions under one roof, as allowed by the Gramm-Leach-Bliley Act, could increase incentives to sell insurance as an add-on to a loan (perhaps under tie-in pressure)—or to inappropriately fund insurance policies through high-cost loans.

As consumers are faced with these changes, it is more important than ever that insurance laws are updated and the consumer protection bar is raised, not lowered.

**Given that Regulation is Important for Consumers, Who Should Regulate—the States or the Federal Government?**

Consumers do not care who regulates insurance; we only care that the regulatory system be excellent. Consumer advocates have been (and are) critical of the current State-based system, but we are not willing to accept a Federal system that guts consumer protections in the States and establishes one uniform but weak set of regulatory standards.

I am one of very few people who have served both as a State regulator (Texas Insurance Commissioner) and as a Federal regulator (Federal Insurance Administrator when the Federal Insurance Administration was in HUD and had responsibility for the co-regulation of homeowners' insurance in the FAIR Plans, as well as flood and crime insurance duties.) I know that either a Federal or the State system can succeed or fail in protecting consumers. What is critical is not the locus of regulation, but the quality of the standards and the effectiveness of enforcement of those standards.

Both a State and a Federal system have potential advantages and disadvantages. Here are some of them:

| Item | Federal | State |
|---|---|---|
| Experience overseeing all aspects of insurance regulation? | No | Yes |
| Responsive to local needs? | No | Yes |
| Handle individual complaints promptly and effectively? | No | Yes |
| Limited impact if regulatory mistakes are made? | No | Yes |
| Not subject to political pressure from national insurers? | No | No |
| Not subject to political pressure from local insurers? | Yes | No |
| More uniform regulatory approach? | Yes | No |
| Can easily respond to micro-trends impacting only a region or a state? | No | Yes |
| Can easily respond to macro-trends that cross state borders? | Yes | No |
| Has greater resources, like date processing capacity? | Yes | No |

Despite many weaknesses that exist in insurance regulation at the State level, a number of States do have high-quality consumer protections. Moreover, the States also have extensive experience regulating insurer safety and soundness and an established system to address and respond to consumer complaints. The burden is on those who for opportunistic reasons now want to shift away from 150 years of State insurance regulation to show that they are not asking Federal regulators and American consumers to accept a dangerous "pig in a poke" that will harm consumers.

CFA agrees that better coordination and more consistent standards for licensing and examinations are desirable and necessary—as long as the standards are of the highest—and not the lowest—quality. We also agree that efficient regulation is important, because consumers pay for inefficiencies. CFA participated in NAIC meetings over many months helping to find ways to eliminate inefficient regulatory practices and delays, even helping to put together a 30-day total product approval package. Our concern is not with cutting fat, but with removing regulatory muscle when consumers are vulnerable.

**Why Have Insurers Suddenly Embraced Federal Regulation?**

The recent conversion of insurers to the concept of Federal regulation is based solely on the notion that such regulation would be weaker. Insurers have, on occasion, sought Federal regulation when the States increased regulatory control and the Federal regulatory attitude was more laissez-faire. Thus, in the 1800's, the industry argued in favor of a Federal role before the Supreme Court in *Paul* v. *Virginia,* but the court ruled that the States controlled because insurance was intrastate commerce.

Later, in the 1943 *SEUA* case, the Court reversed itself, declaring that insurance was interstate commerce and that Federal antitrust and other laws applied to insurance. By this time, Franklin Roosevelt was in office and the Federal Government was a tougher regulator than were the States. The industry sought, and obtained, the McCarran-Ferguson Act. This law delegated exclusive authority for insurance regulation to the States, with no routine Congressional review. The Act also granted insurers a virtually unheard of exemption from antitrust laws, which allowed insurance companies to collude in setting rates and to pursue other anticompetitive practices without fear of Federal prosecution.

From 1943 until recently, the insurance industry has violently opposed *any* Federal role in insurance regulation. In 1980, insurers successfully lobbied to stop the Federal Trade Commission from investigating deceptive acts and practices of *any kind* in the insurance industry. They also convinced the White House that year to eliminate the Federal Insurance Administration's work on insurance matters other than flood insurance. Since that time, the industry has successfully scuttled any attempt to require insurers to comply with Federal antitrust laws and has even tried to avoid complying with Federal civil rights laws.

Notice that the insurance industry is very pragmatic in their selection of a preferred regulator. They always favor the least regulation. It is not surprising that, today, the industry would again seek a Federal role at a time they perceive little regulatory interest at the Federal level. But, rather than going for full Federal control, they have learned that there are ebbs and flows in regulatory oversight at the Federal and State levels, so they seek the ability to switch back and forth at will.

Further, the insurance industry has used the possibility of an increased Federal role to pressure NAIC and the States into gutting consumer protections over the last 3 or 4 years. Insurers have repeatedly warned States that the only way to preserve their control over insurance regulation is to weaken consumer protections.[3] They have been assisted in this effort by a series of House hearings, which rather than focusing on the need for improved consumer protection have served as a platform for a few Representatives to issue ominous statements calling on the States to further deregulate insurance oversight, "or else." Most recently, some House Members have floated a "road map" for insurance deregulation (known as the "SMART" bill), a plan that would greatly harm America's insurance consumers.

This strategy of "whipsawing" State regulators to lower standards benefits all elements of the insurance industry, even those that do not support any Federal regulatory approach. Even if Congress does nothing, the threat of Federal intervention is enough to scare State regulators into acceding to insurer demands.

Unfortunately for consumers, the strategy has already paid off, before the first insurance bill is ever marked up in Congress. In the last few years, the NAIC has moved suddenly to cut consumer protections adopted over a period of decades. The NAIC has also failed to act in the face of a number of serious problems facing consumers in the insurance market.

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[3] The clearest attempt to inappropriately pressure the NAIC occurred at their spring 2001 meeting in Nashville. There, speaking on behalf of the entire industry, Paul Mattera of Liberty Mutual Insurance Company told the NAIC that they were losing insurance companies every day to political support for the Federal option and that their huge effort in 2000 to deregulate and speed product approval was too little, too late. He called for an immediate step-up of deregulation and measurable "victories" of deregulation to stem the tide. In a July 9, 2001 *Wall Street Journal* article by Chris Oster, Mattera admitted his intent was to get a "headline or two to get people refocused." His remarks were so offensive that I went up to several top commissioners immediately afterwards and said that Materra's speech was the most embarrassing thing I had witnessed in 40 years of attending NAIC meetings. I was particularly embarrassed since no commissioner challenged Mattera and many had almost begged him to grant them more time to deliver whatever the industry wanted.

Jane Bryant Quinn, in her speech to the NAIC on October 3, 2000, said: "Now the industry is pressing State regulators to be even more hands-off with the threat that otherwise they'll go to the feds." So other observers of the NAIC see this pressure as potentially damaging to consumers.

Larry Forrester, President of the National Association of Mutual Insurance Companies (NAMIC), wrote an article in the *National Underwriter* of June 4, 2000. In it he said, " . . . how long will Congress and our own industry watch and wait while our competitors continue to operate in a more uniform and less burdensome regulatory environment? Momentum for Federal regulation appears to be building in Washington and State officials should be as aware of it as any of the rest of us who have lobbyists in the Nation's capital . . . NAIC's ideas for speed-to-market, complete with deadlines for action, are especially important. Congress and the industry will be watching closely . . . The long knives for State regulation are already out . . ."

In a press release entitled "Alliance Advocates Simplification of Personal Lines Regulation at NCOIL Meeting; Sees it as Key to Fighting Federal Control" dated March 2, 2001, John Lobert, Senior VP of the Alliance of American Insurers, said, "Absent prompt and rapid progress (in deregulation) . . . others in the financial services industry—including insurers—will aggressively pursue Federal regulation of our business . . ."

*NAIC Failures To Act*

1. Failure to do anything about abuses in the small face life market. Instead, NAIC adopted an incomprehensible disclosure on premiums exceeding benefits, but did nothing on overcharges, multiple policies, or unfair sales practices.

2. Failure to do anything meaningful about unsuitable sales in any line of insurance. Suitability requirements still do not exist for life insurance sales even in the wake of the remarkable market conduct scandals of the late 1980's and early 1990's. A senior annuities protection model was finally adopted (after years of debate) that is so limited as to do nothing to protect consumers.

3. Failure to call for collection and public disclosure of market performance data after years of requests for regulators to enhance market data, as NAIC weakened consumer protections. How does one test whether a market is workably competitive without data on market shares by zip code and other tests?

4. Failure to do anything as an organization on the use of credit scoring for insurance purposes. In the absence of NAIC action, industry misinformation about credit scoring has dominated State legislative debates. NAIC's failure to analyze the issue and perform any studies on consumer impact, especially on lower-income consumers and minorities, has been a remarkable dereliction of duty.

5. Failure to address problems with risk selection. There has not even been a discussion of insurers' explosive use of underwriting and rating factors targeted at socio-economic characteristics: Credit scoring, check writing, prior bodily injury coverage amounts purchased by the applicant, prior insurer, prior nonstandard insurer, not-at-fault claims, not to mention use of genetic information, where Congress has had to recently act to fill the regulatory void.

6. Failure to do anything on single premium credit insurance abuses.

7. Failure to take recent steps on redlining or insurance availability or affordability. Many States no longer even look at these issues, 30 years after the Federal Government issued studies documenting the abusive practices of insurers in this regard. Yet, ongoing lawsuits continue to reveal that redlining practices harm the most vulnerable consumers.

*NAIC Rollbacks Of Consumer Protections*

1. The NAIC pushed through small business property/casualty deregulation, without doing anything to reflect consumer concerns (indeed, even refusing to tell consumer groups why they rejected their specific proposals) or to upgrade "back-end" market conduct quality, despite promises to do so. As a result, many States adopted the approach and have rolled back their regulatory protections for small businesses. Nebraska and New Hampshire joined the list of States that have deregulated just this year.

2. States are rolling back consumer protections in auto insurance as well. New Jersey, Texas, Louisiana, and New Hampshire have done so in the last 2 years.

3. Last year, the NAIC just terminated free access for consumers to the annual statements of insurance companies at a time when the need for enhanced disclosure is needed if price regulation is to be reduced.

**Can Competition Alone Guarantee a Fair, Competitive Insurance Market?**

Consumers, who over the last 30 years have been the victims of vanishing premiums, churning, race-based pricing, creaming, and consumer credit insurance policies that pay pennies in claims per dollar in premium, are not clamoring for such policies to be brought to market with even less regulatory oversight than in the past. The fact that "speed-to-market" has been identified as a vital issue in modernizing insurance regulation demonstrates that some policymakers have bought into insurers' claims that less regulation benefits consumers. We disagree. We think smarter, more efficient regulation benefits both consumers and insurers and leads to more beneficial competition. Mindless deregulation, on the other hand, will harm consumers.

The need for better regulation that benefits both consumers and insurers is being exploited by some in the insurance industry to eliminate the most effective aspects of State insurance regulation such as rate regulation, in favor of a model based on the premise that competition alone will protect consumers.[4] We question the entire

[4] If America moves to a "competitive" model, certain steps must first be taken to ensure "true competition" and prevent consumer harm. First, insurance lines must be assessed to determine whether a competitive model, for example, the alleviation of rate regulation, is even appropriate. This assessment must have as its focus how the market works for consumers. For example, States cannot do away with rate regulation of consumer credit insurance and other types of insurance subject to reverse competition. The need for relative cost information and the complexity of the line/policy are factors that must be considered.

foundation behind the assumption that virtually no front-end regulation of insurance rates and terms coupled with more back-end (market conduct) regulation is better for consumers. The track record of market conduct regulation has been extremely poor. As noted above, insurance regulators rarely are the first to identify major problems in the marketplace.

Given this track record, market conduct standards and examinations by regulators must be dramatically improved to enable regulators to become the first to identify and fix problems in the marketplace and to address market conduct problems on a national basis. From an efficiency and consumer protection perspective, it makes no sense to lessen efforts to prevent the introduction of unfair and inappropriate policies in the marketplace. It takes far less effort to prevent an inappropriate insurance policy or market practice from being introduced than to examine the practice, stop a company from doing it and provide proper restitution to consumers after the fact.

The unique nature of insurance policies and insurance companies requires more extensive front-end regulation than other consumer commodities. And while insurance markets can be structured to promote beneficial price competition, deregulation does not lead to, let alone guarantee, such beneficial price competition.

Front-end regulation should be designed to prevent market conduct problems from occurring instead of inviting those problems to occur. It should also promote beneficial competition, such as price competition and loss mitigation efforts, and deter destructive competition, such as selection competition, and unfair sales and claims settlement practices. Simply stated, strong, smart, efficient, and consistent front-end regulation is critical for meaningful consumer protection and absolutely necessary to any meaningful modernization of insurance regulation.

**Is Regulation Incompatible With Competition?**

The insurance industry promotes a myth: 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 proof that competition and regulation can work together to benefit consumers and the industry is the manner in which California regulates auto insurance under Proposition 103. Indeed, that was the theory of the drafters (including me) of Proposition 103. Before Proposition 103, Californians had experienced significant price increases under a system of "open competition" of the sort the insurers now seek at the Federal level. (No regulation of price is permitted but rate collusion by rating bureaus is allowed, while consumers receive very little help in getting information.) 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 insur-

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If certain lines are identified as appropriate for a "competitive" system, before such a system can be implemented, the following must be in place:

- Policies must be transparent: Disclosure, policy form, and other laws must create transparent policies. Consumers must be able to comprehend the policy's value, coverage, actual costs, including commissions and fees. If consumers cannot adequately compare actual costs and value, and if consumers are not given the best rate for which they qualify, there can be no true competition.
- Policies should be standardized to promote comparison-shopping.
- Antitrust laws must apply.
- Anti-rebate, antigroup, and other anticompetitive State laws must be repealed.
- Strong market conduct and enforcement rules must be in place with adequate penalties to serve as an incentive to compete fairly and honestly.
- Consumers must be able to hold companies legally accountable through strong private remedies for losses suffered as a result of company wrongdoing.
- Consumers must have knowledge of and control over flow and access of data about their insurance history through strong privacy rules.
- There must be an independent consumer advocate to review and assess the market, assure the public that the market is workably competitive, and determine if policies are transparent.

Safeguards to protect against competition based solely on risk selection must also be in place to prevent redlining and other problems, particularly with policies that are subject to either a public or private mandate. If a competitive system is implemented, the market must be tested on a regular basis to make sure that the system is working and to identify any market dislocations. Standby rate regulation should be available in the event the "competitive model" becomes dysfunctional.

If the industry will not agree to disclosing actual costs, including all fees and commissions, ensuring transparency of policies, strong market conduct rules and enforcement then it is not advocating true competition, only deregulation.

ance rates and forms in the Nation, with very clear rules on how rates would be judged.

As our in-depth study of regulation by the States revealed,[5] 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 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.

I can update this information through 2001.[6] As of 2001, the average annual premium in California was $688.89 (23rd in the Nation) versus $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!

**How Can Uniformity be Achieved Without Loss of Consumer Protections?**

CFA would endorse a more uniform national or multi-State approach if certain rigorous conditions were met. The attached fact sheet, *Consumer Principles and Standards for Insurance Regulation,* provides detailed standards that regulators should meet to properly protect consumers, whether at the State, multi-State, or national level. It should be noted that none of the proposals offered by insurers or on behalf of insurers (such as the Oxley-Baker "SMART" proposal) come close to meeting these standards.*

One obvious vehicle for multi-State enforcement of insurance standards is the NAIC. We have favored empowering the NAIC to implement such a multi-State approach only if the NAIC's decisionmaking procedures are overhauled to make it a more transparent, accountable body with meaningful regulatory powers. As stated above, recent NAIC failures demonstrate that it is not an impartial regulatory body that can be counted on to adequately consider consumer needs.

Because of its historical domination by the insurance industry, consumer organizations are extremely skeptical about its ability to confer national treatment in a fair and democratic way. It is essential that any Federal legislation to empower the NAIC include standards to prevent undue industry influence and ensure the NAIC can operate as an effective regulatory entity, including:

- Democratic processes/accountability to the public, which must include: Notice and comment rulemaking; on the record voting; accurate minutes; rules against exparte communication; public meeting/disclosure/sunshine rules.
- A decisionmaking process subject to an excellent Administrative Procedures Act.
- Strong conflict of interest and revolving door statutes similar to those of the Federal Government to prevent undue insurance industry influence. If decisionmaking members of the NAIC have connections, past or present, to certain companies, the process will not be perceived as fair.
- Independent funding. The NAIC cannot serve as a regulatory entity if it relies on the industry for its funding. The bill should establish a system of State funding to the NAIC at a set percentage of premium so that all States and insured entities equally fund the NAIC.
- National Independent Advocate. To offset industry domination, an independent, national, public insurance counsel/ombudsman with necessary funding is needed. Consumers must be adequately represented in the process for the process to be accountable and credible.

*Regulation By Domiciliary States Will Lead to Unacceptably Weak Standards*

We oppose allowing a domiciliary State to essentially act as a national regulator by allowing domiciled companies to comply only with that State's standards. This approach has several potential problems, including:

- It promotes forum shopping. Companies would move from State-to-State to secure regulation from the State that has the least capacity to regulate, provoking a "race to the bottom."
- The State of domicile is often under the greatest political and economic pressure not to act to end harmful business practices by a powerful in-State company.

[5] "Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation," June 6, 2000; *www.consumerfed.org.*

[6] State Average Expenditures & Premiums for Personal Automobile Insurance in 2001, NAIC, July 2003.

* Held in Committee files.

- The resources of States to properly regulate insurance vary widely.
- It is antithetical to States' rights to apply laws from other States to any business operating within their borders. If such a move is made, however, it is imperative that consumers have a national, independent advocate.
- It promotes a lack of consistency in regulation because companies could change domiciliary State status.
- Residents of one State cannot be adequately represented by the legislature/executive of another. If a resident's State consumer protections did not apply, the resident would be subject to laws of a State in which they have no representation. How can a consumer living in Colorado influence decisions made in Connecticut?
- Rather than focusing on protecting consumers, this system would change the focus to protecting itself and its regulatory turf, as has happened in the bank regulatory system. State and Federal banking regulators have competed to lower their consumer protections to lure banks to their system.
- We would be particularly concerned with proposals to give exclusive control of market conduct exams to a domiciliary State. Unscheduled exams by a State are very important for that State's ability to protect its consumers from abuse. States must retain the ability to act quickly based on complaints or other information.

*"One-Stop" Policy Approval Must Meet High Standards*

Allowing insurers to get approval for their products from a single, unaccountable, non-State regulatory entity would also lead to extremely weak protections unless several conditions are met:

- An entity, such as the NAIC's Coordinated Advertising, Rate and Form Review Authority (CARFRA), that is not subject to authorizing legislation, due process standards, public accountability, prohibitions on ex-parte communications, and similar standards should not have the authority to determine which lines would be subject to one-stop approval process or develop national standards. It also must have funding through the States, not directly from insurers. Independent funding ensures that the regulatory entity is not subject to unfair and detrimental industry influence.
- Any standards that apply must be high and improve the ability of consumers to understand policies and compare on the basis of price. Consumers do not want "speed-to-market" for bad policies.
- Any entity that serves as national standard setter, reviewer and/or approver needs Federal authorizing legislation. An "interstate compact" or "memorandum of understanding" is unworkable and unaccountable.
- Giving the regulated insurer the option to choose which entity regulates it is an invitation to a race to the bottom for regulatory standards.
- Standardization of forms by line has the potential to assist consumers if done in such a way to enhance understanding of terms, benefits, limitations, and actual costs of policies.
- Public/consumer input is essential if the entity makes decisions that ultimately affect information provided to and rates charged consumers.
- We support the concept of an electronic central filing repository, but the public must have access to it.
- To retain oversight of policies and rates affecting their residents, States must have the ability to reject decisions of the entity.
- Any national system must include a national, externally funded consumer-public advocate/counsel to represent consumers in standard setting, development of forms, rate approval, etc.

**Current Federal Proposals**

Three major proposals have surfaced, two of which do not meet the basic standards of consumer protection cited above. Several trade associations have drafted legislation that would create an "optional Federal charter" for insurance regulation, patterned on the Nation's bifurcated Federal/State bank chartering structure. In response, Senator Ernest Hollings last year introduced S. 1373, which would establish Federal minimum standards for insurance regulation and repeal insurers' antitrust exemption under the McCarran Ferguson Act. Senator Hollings' goal was to prevent competition between State and Federal regulators to lower standards. Most recently, Representatives Michael Oxley and Richard Baker have circulated a discussion draft entitled the "State Modernization and Regulatory Transparency (SMART) Act." We will comment separately on each.

*Optional Federal Insurance Charter*

The bills that have been drafted by trade associations like the American Bankers Association and the American Council of Life Insurers would create a Federal regulator that would have little, if any, authority to regulate price or product, regardless of how noncompetitive the market for a particular line of insurance might be. Insurers would be able to choose whether to be regulated by this Federal body or by State regulators. These bills represent the wish list of insurer interests, and include minimal, if any, regulation, coupled with little improvement in consumer information or protection systems.

Consumer organizations strongly oppose an optional Federal charter, where the regulated, at its sole discretion, gets to pick its regulator. This is a prescription for regulatory arbitrage that can only undermine needed consumer protections. Indeed, the drafters of such proposals have openly stated that this is their goal with the optional charter approach. If elements of the insurance industry truly want to obtain "speed-to-market" and other advantages through a Federal regulator, let them propose a Federal approach that does not allow insurers to run back to the States when regulation gets tougher. We could all debate the merits of that approach.

CFA and the entire consumer community stand ready to fight optional charters with all the strength we can muster.

*The Insurance Consumer Protection Act of 2003, S. 1373*

Only one bill currently before Congress considers the consumer perspective in its design, adopting many of the consumer protection standards cited in this testimony. That is S. 1373 by Senator Hollings. The bill would adopt a unitary Federal regulatory system under which all interstate insurers would be regulated. Intrastate insurers would continue to be regulated by the States.

The bill's regulatory structure requires Federal prior approval of prices to protect consumers, including some of the approval procedures (such as hearing requirements when prices change significantly) being used so effectively in California. It requires annual market conduct exams. It creates an office of consumer protection. It enhances competition by removing the antitrust protection insurers hide behind in ratemaking. It improves consumer information and creates a system of consumer feedback.

If Federal regulation is to be considered, S. 1373 should be the baseline for any debate on the subject before this Committee.

*SMART Act*

Rather than increase insurance consumer protections for individuals and small businesses while spurring States to increase the uniformity of insurance regulation, this sweeping proposal would override important State consumer protection laws, sanction anticompetitive practices by insurance companies, and incite State regulators into a competition to further weaken insurance oversight. It is quite simply one of the most grievously flawed and one-sided pieces of legislation that we have ever seen with absolutely no protections offered for consumers. The consumers who will be harmed by it are our Nation's most vulnerable: The oldest, the poorest, and the sickest.

For example, the discussion draft would preempt State regulation of insurance rates. This would leave millions of consumers vulnerable to price gouging, as well as abusive and discriminatory insurance classification practices. It would also encourage 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, such as credit scores, territorial data, and the details of consumers' prior insurance history, for pricing purposes. The draft bill goes so far as to deregulate cartel-like organizations such as the Insurance Services Office and the National Council on Compensation Insurance, while leaving the Federal antitrust exemption fully intact.

What the draft does not do is as revealing as what it does require. It does not create a Federal office to represent consumer interests, although the draft creates two positions to represent insurer interests. It takes no steps to spur increased competition in the insurance industry, such as providing assistance or information to the millions of consumers who find it extremely difficult to comparison shop for this complex and expensive product, or eliminating the antitrust exemption that insurers currently enjoy under the McCarran-Ferguson Act. Insurers are not required to meet community reinvestment requirements, as banks are, to guarantee that insurance is available in underserved communities. Nothing is done to prevent insurers from using inappropriate information, such as credit scores or a person's income, to develop insurance rates.

CFA supports the goals outlined in several sections of this draft. As stated above, we are not opposed to increasing uniformity in insurance regulation. Unfortunately, however, in almost every circumstance in which the draft attempts to ensure uniformity, it chooses the weakest consumer protection approach possible. (For more details on CFA's concerns with this draft, please see the attached letter to House Financial Services leaders dated September 9, 2004.) *

*Federal Insurance Reform that Insurers Won't Discuss: Amending the McCarran Act to Provide Federal Oversight and, Perhaps, Minimum Standards for Efficient and Effective Regulation*

Insurers want competition to set rates, they say. How about a simple repeal of the antitrust exemption in the McCarran Act to test their desire to compete under the same rules as normal American businesses do?

Another amendment to the McCarran Act we would suggest is to do what should have been done at the beginning of the delegation of authority to the States: Have the FTC and other Federal agencies perform scheduled oversight of the States' regulatory performance and propose minimum standards for effective and efficient consumer protection. The Hollings bill or relevant provisions of Proposition 103 in California might be the basis for such minimum standards.

**Conclusion**

CFA looks forward to working with the Committee to strengthen consumer protection for insurance consumers, Mr. Chairman. I will be happy to respond to questions at the appropriate time.

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## PREPARED STATEMENT OF ALAN F. LIEBOWITZ

PRESIDENT, OMNIA (BERMUDA) LTD.

ON BEHALF OF THE

AMERICAN BANKERS INSURANCE ASSOCIATION

SEPTEMBER 22, 2004

Mr. Chairman and Members of the Committee, my name is Alan Liebowitz, and I am President of OMNIA (Bermuda) Ltd., an insurance company affiliated with the Old Mutual Financial Network. Old Mutual is a global diversified financial services network that extends from Europe to Asia, Africa, and North America. In the United States, the Old Mutual Financial Network provides retirement savings and financial protection products in all 50 States through Fidelity & Guaranty Life, Americom Life & Annuity, and Fidelity & Guaranty Life of New York. Our life insurance companies have combined assets of over $12 billion and serve nearly 650,000 policyholders. Prior to joining OMNIA, I was the General Counsel for Citibank's insurance initiative and president of certain of its domestic insurance companies. During my 15 years at Citibank, I was actively involved in the efforts to permit Citibank's Delaware subsidiary bank to underwrite insurance.

I am here today on behalf of the American Bankers Insurance Association (ABIA). ABIA is a subsidiary of the American Bankers Association. ABIA's members are banking institutions that are engaged in the business of insurance and insurance companies and administrators that provide insurance products or services to banks.

Thank you for the opportunity to participate in this hearing on the condition and regulation of the insurance industry. We have concluded that the current insurance regulatory system is badly in need of reform and note that the organizations at this table agree with that fundamental premise. Virtually all industry participants and even insurance regulators have spent years detailing the failings of the State system and are now beginning to define appropriate solutions to the problem.

In general, the main criticisms of the State system include its lack of uniformity in licensing standards, its inability to bring insurance products to market within a reasonable time-frame, and the need for greater uniformity in oversight of market conduct.

In response to these criticisms, House Financial Services Committee Chairman Mike Oxley and Capital Markets Subcommittee Chairman Richard Baker developed a draft "Roadmap" for modernizing the State system of regulation. Recently, this "Roadmap" has been translated into an actual legislative proposal. The Oxley-Baker plan is comprehensive in scope and is the product of a long review process involving careful and thoughtful deliberation. We are pleased that the House has elected to begin legislating solutions to these problems and we look forward to working with the Chairmen as the legislative process moves forward.

Similarly, the States have made some progress with their plan for achieving uniformity. The National Association of Insurance Commissioners (NAIC) has focused

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* Held in Committee files.

its energies on the adoption of an Interstate Compact for life insurance products and the nationwide adoption of its Model Laws. ABIA is supportive of the NAIC's work, as it represents a good faith effort toward achieving uniformity of regulation.

ABIA is not alone in trying to encourage the States and the Congress in their efforts to bring modernization to insurance regulation. Others share a similar goal and all of us want these efforts to succeed. However, while there are several approaches to modernizing insurance regulation, we have concluded that the best approach is the creation of a Federal chartering and regulatory system that serves as an alternative to the current State insurance regulatory system. Our approach requires the establishment of an "Optional Federal Charter", which addresses the shortcomings of the existing State insurance regulatory system, yet preserves the State system for those who prefer it.

In the balance of my statement, I will explain the involvement of banks in the business of insurance; more fully describe the problems with the current system of State insurance regulation; explain our optional Federal chartering and regulation alternative; and, last, show how that alternative would protect and benefit consumers.

**ABIA's Members Are Actively Engaged in the Business of Insurance**

Banking institutions have long been involved in the business of insurance, principally as agents. The level and scope of that involvement has expanded significantly in recent years. ABIA estimates that in 2002, the banking industry produced almost $70 billion in insurance premiums. This is a 26 percent increase over the 2001 estimate of $55 billion in premiums. ABIA also estimates that there are over 2,000 banks involved in the distribution of insurance. This includes some of the Nation's largest agent networks. In fact, we estimate that banking institutions employ over 50,000 licensed insurance agents.

Two laws passed by the Congress have contributed to the growth in bank insurance activities. First, the Riegle-Neal Interstate Banking and Branching Act of 1994 allowed banking organizations to establish nationwide offices through which they can offer insurance products and annuities. These multi-State offices not only have expanded bank insurance sales, but also have given our industry a unique exposure to the variations in State insurance laws and regulations. Second, the Gramm-Leach-Bliley Act authorized affiliations between banks and insurance companies. These affiliations have more closely aligned the banking industry with the insurance industry, and have given ABIA an even deeper appreciation of the current State of insurance regulation.

**Problems With the Current Insurance Regulatory System**

While the States have a commendable record of protecting consumers from insurance insolvencies, they also have a record of inconsistent and inefficient regulation that results in unnecessary costs and lost opportunities for consumers. In past testimony before the Congress, former NAIC President Ernst Csiszar described eight areas of insurance regulation in need of reform.[1] I will highlight the three areas of most importance to bank-insurance operations: Producer licensing, rate regulation, and product approval.

*Producer Licensing*

ABIA's members are particularly familiar with the patchwork of disparate laws applicable to the licensing of insurance agents. For example, different States impose different qualification and testing standards and different continuing education requirements. Licenses recognized in one State are not necessarily recognized in another State. Agents associated with banks are sometimes subject to sales limitations not applicable to agents not associated with banks. For organizations that operate agent networks in multiple States, these differences impose compliance costs and burdens that are both significant and ultimately borne by consumers.

Continued disharmony among States' producer licensing laws persists despite a considerable Congressional effort to eradicate it. In 1999, as part of the Gramm-Leach-Bliley (GLB) Act, Congress adopted two limited requirements designed to promote uniformity and reduce discrimination in the rules applicable to producer licensing and insurance sales. The first appears in Section 104 of the GLB Act. This Section includes a preemption standard designed to prevent the States from discriminating against depository institutions engaged in the sale of insurance. Following the enactment of Section 104, ABIA identified insurance sales laws in 33

[1] Testimony of Ernst Csiszar, Director of Insurance, South Carolina Department of Insurance, before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Financial Services Committee, U.S. House of Representatives, Wednesday March 31, 2004.

States that by varying degrees conflict with and are preempted by the standard. We made this list available to State insurance authorities and the NAIC, urging them to repeal or otherwise not enforce the offending laws. Our appeal to the States continues to be largely ignored.

As a result, several national banks requested preemption opinions from the Office of the Comptroller of the Currency (OCC). Where OCC opinions have been issued (that is, on State insurance sales laws in Massachusetts and West Virginia that are uniquely applicable to depository institutions), they have been the subjects of lawsuits in Federal courts. Those courts that have rendered judgment to date have ruled against the States. Even these judicial actions, however, have been ignored and have failed to cause other States to modify their laws.

The GLB Act also included provisions designed to encourage the States to reform their producer licensing laws and regulations. These so-called "NARAB provisions" required the establishment of an organization to develop uniform licensing rules and regulations but only if a majority of the States did not adopt either uniform or reciprocal licensing laws and regulations within 3 years of the date of enactment of the GLB Act. To facilitate compliance with the GLB Act, the NAIC developed a reciprocal licensing Model Act, which has currently been adopted by only about 40 States. Because the States could avoid NARAB—and the uniformity mandate it represented—if only a majority of States enacted the Model, that action by a majority of States has allowed some States, including some of the largest States like California, to avoid the issue of licensing reform entirely.

And, the more important goal of achieving licensing uniformity has been put off indefinitely. The GLB Act allowed the goal of uniform agent licensing laws to remain unrealized so long as a majority of States passed reciprocal licensing laws. Unfortunately, reciprocity is not uniformity. Instead, it is the recognition and acceptance of differences between States. Five years after passage of the GLB Act, significant differences in State licensing laws remain.

*Rate Regulation*

ABIA's members are also familiar with the anticonsumer effects of price controls. Congress repealed the last vestiges of Federal price controls on banking products over 20 years ago after it realized that such artificial constraints do more harm than good. Today, however, the insurance industry continues to be subject to extensive price regulation—to the disadvantage of consumers. In most States, an insurance product can only be sold after the State insurance regulator approves the price of an insurance product. Some States regulate the price of an insurance policy; some States regulate the loss ratio a given product line must maintain.

Price controls are only appropriate, arguably, when associated with a utility or a monopoly. In such situations, a single company could set and hold prices at unreasonable levels. The insurance industry, however, is a competitive industry. There are thousands of insurers operating in the United States, and there are no significant barriers to entry for new companies. In such a competitive market, competition between firms will protect consumers from unfair pricing schemes much more efficiently than the Government.

The consumer benefits associated with competitive rates are more than just speculative. Several States already have moved away from rate regulation, and, in those States, there is evidence that rates have fallen on certain products. A study by Scott Harrington for the AEI-Brookings Joint Center for Regulatory Studies entitled "Insurance Deregulation and the Public Interest" found that auto insurance is less costly and more available in 14 States that do not require prior approval of rates than in 27 other States that do require prior approval.

*Product Approval*

Similar to price controls, most States' insurance departments will not approve an insurance policy for sale unless subject to prior review by the insurance regulator. ABIA's members have found that the impediments created by most States' prior approval requirements have had the undesirable effect of depriving consumers of innovative insurance products and retarded the ability of insurers to develop these products in a timely fashion.

Under the current State system of insurance regulation, it can take months, and sometimes years, for a company to receive permission from State insurance regulators to introduce a new product in every State. Such delays are an inevitable result of a system in which every State has an opportunity to review and approve insurance products and where the standards of review are different in every State. If the insurance industry cannot gain some relief from the States' prior approval regime, life insurers will continue to lose market share to other noninsurance investment products and property and casualty insurers will reduce or eliminate their efforts to develop innovative products that offer more comprehensive benefits at lower costs.

**ABIA Supports Optional Federal Insurance Chartering**

ABIA believes that the answer to the problems inherent in the current State insurance regulatory system is the creation of an optional Federal insurance chartering system for insurers and insurance agencies.

Seven years ago, ABIA developed its own "blueprint" for insurance regulatory reform patterned after the dual banking system. That blueprint called for the optional chartering of insurers and insurance agencies by either the Federal Government or the States. Our goal was not to replace or duplicate State insurance regulation, but to create an alternative to State insurance regulation. Optional chartering has worked well in the banking industry, and we saw no reason to believe it could not work well in the insurance industry.

When we first developed our blueprint, Congress was actively debating the Gramm-Leach-Bliley Act. Therefore, we put our blueprint on the back burner until action on that bill was complete. After the Gramm-Leach-Bliley Act was finalized, we made optional Federal chartering a priority. We converted our blueprint into a specific legislative proposal and unveiled it at a conference organized by the American Enterprise Institute in the fall of 2000.

Our optional Federal chartering proposal was a natural outgrowth of the banking industry's experience with the dual banking system. That system, which permits banking institutions to voluntarily choose between a Federal or State charter, has been in place for over 140 years, and is widely perceived to be a great success.

Initially, our proposal received a mixed reception. State insurance regulators, some insurance trade groups, and representatives of consumer groups expressed various concerns and reservations. Other insurance trade groups offered quiet encouragement.

We soon joined forces with two other insurance trade groups, the American Council of Life Insurers and the American Insurance Association, each of which had developed its own proposal, to develop a common optional Federal chartering proposal. The first step in that cooperative effort was the development of a set of principles around which a legislative proposal could be structured. The second step was the drafting of a consensus bill. The end product incorporates the best of State insurance regulation into a single Federal/State optional chartering framework similar in structure to the dual banking system.

**The Consensus Optional Federal Charter Proposal**

The following are some of the key features of that consensus bill:

- *Office of National Insurance/National Insurance Commissioner*—The bill calls for the establishment of a new independent bureau within the Treasury Department, the Office of National Insurance. The National Insurance Commissioner, who would be empowered to charter, regulate, and supervise national insurance companies and national insurance agencies, would head this office. The Commissioner would be a Presidential appointee, subject to Senate confirmation, and subject to a 5-year term. The bill requires the establishment of a consumer protection division and a fraud division within the Office. Start up funding for the Office would be provided by a loan from the Treasury, which must be repaid over 30 years. On-going funding would be provided by assessments imposed upon federally chartered insurers and agencies.
- *National Insurers*—One of the central powers of the Commissioner would be the chartering of national insurance companies. Such companies could be organized in stock, mutual, or fraternal form. As a general rule, national insurance companies would be subject to the exclusive regulation of the Office and the Commissioner. federally chartered insurers would be required to obtain a license from the Commissioner to underwrite specific types (or lines) of insurance. A federally chartered insurer could not be licensed to underwrite both life insurance and property and casualty insurance. However, the bill permits an insurance holding company to own both life and property and casualty insurers. The Commissioner would not issue a license for the underwriting of health insurance until 3 years after the date of enactment of the bill. Existing State-licensed insurers could exchange a State license for a national charter and national license.
- *Solvency Regulations*—The Commissioner would be required to regulate the solvency of national insurers. For the first 5 years after the enactment of the bill, Federal solvency regulations would be based upon existing NAIC models, including the NAIC model accounting standards and the NAIC model risk-based capital standards.

- *Product Regulation*—As a general rule, a national insurer would not be subject to rate or form regulation. The Commissioner would be directed to develop policy standards for life insurance companies, and such companies would be required to file their forms with the Commissioner. However, these forms would not be subject to review or approval prior to their use by the company. Similarly, property and casualty companies would be required to file, annually, a list of standard policy forms, but, again, these forms would not be subject to prior review or approval. The Commissioner would review rates for long-term care insurance and disability insurance.
- *Market Conduct*—The Commissioner would be directed to issue regulations governing the market conduct of national insurers. Such regulations would address marketing and claims practices.
- *Corporate Organization*—The bill provides for insurance holding companies, which could own both State licensed and federally chartered insurers. The bill also provides for changes in corporate control, demutualizations, mergers and acquisitions. These provisions are patterned after model State laws.
- *National Insurance Agencies*—The bill provides for the chartering of national insurance agencies and issuance of Federal producers' licenses. (Every national insurance agency would be required to hold a Federal producers' license.) federally licensed producers could sell policies for any federally chartered insurer or any State insurer. States could not regulate sales of policies issued by federally chartered insurers. However, States could require a Federal producer to obtain a limited license to sell policies issued by a State insurer. The limited license would subject the producer to State market conduct standards.
- *State Law*—As a general rule, national insurers, national insurance agencies and federally licensed producers are not subject to State insurance regulations. However, federally chartered property and casualty companies would be subject to State reparations statutes, which define the scope of property and casualty policies. Also, national insurance agencies that sell policies for State licensed insurers may be required to obtain limited State licenses. National insurers also would be subject to State tax laws, including premium tax requirements.
- *Insolvencies*—The bill includes receivership provisions patterned after a model Interstate Insurance Receivership Compact proposal developed in 1998. Under those provisions, Federal courts, not State courts, would handle the receiverships of national insurers. The bill requires national insurers to be members of the State guarantee associations in those States where they do business. However, if a State's guaranty statute does not provide policyholders certain minimum standards of protection, a Federal guarantee association would step in and guaranty the policies issued by insurers operating in that State. States are given 4 years to meet these minimum standards.

In sum, the bill provides insurers and agencies a chartering and supervisory alternative to State insurance regulation. It does so in a manner that safeguards the interests of policyholders and the public-at-large. It also does so in a manner that preserves the integrity of State regulations. State authority over State-licensed insurers and agencies is untouched. State authority to tax all insurers and agencies is recognized. State guaranty systems are left in place.

**Consumer Protections and Optional Federal Chartering**

ABIA's member companies are driven by the needs and demands of consumers, so we recognized early on that any insurance modernization proposal must be responsive to those needs and demands. ABIA believes the consensus optional Federal charter proposal benefits consumers in several respects: It assures consumers access to sound insurance products in a fair manner; it is responsive to the changing needs of consumers; and, it creates a dynamic tension between State and Federal regulators that is in the best interests of consumers.

*Federal Solvency and Market Conduct Standards Ensure That Consumers Have Access to Sound Insurance Products in a Fair Manner*

Optional Federal regulation of insurers and producers fully and fairly protects the rights and interests of the consumers of insurance through Federal solvency standards. These standards include risk-based capital requirements (which will ensure that national insurers are adequately capitalized); investment standards (which require a national insurer to invest assets prudently); and, dividend restrictions (which prevent insolvent national insurers from paying dividends). Such standards give consumers confidence that a federally chartered insurer is able to pay claims on its policies.

The consensus proposal backs Federal solvency standards with regular examinations and enforcement actions. These examination and supervisory powers signal to consumers that federally chartered insurers are safe and sound. Examination and enforcement standards include the authority to require federally chartered insurers to file regular reports on their operations and financial condition; the authority to regularly examine federally chartered insurers, and to the extent appropriate, their affiliates; and the authority to initiate an enforcement action against federally chartered insurers that fail to comply with applicable standards. Enforcement penalties are patterned after those available to Federal banking regulators, which include the power to remove officers and directors and to impose civil money penalties of up to $1 million a day.

Optional Federal chartering also protects consumers through Federal market conduct standards. Such standards protect consumers by preventing unfair methods of competition and unfair and deceptive acts and practices in the advertising, sale, issuance, distribution, and administration of insurance policies.

Critics of optional Federal chartering often claim that a Federal insurance regulator would not be able to adequately police sales and claims practices by national insurers or producers. Some of these critics even cite the hundreds of thousands of consumer complaints filed annually with State insurance regulators in support of this claim. The Federal regulation of the banking industry shows that Federal agencies can effectively enforce consumer protection standards.

Today, thousands of banks are offering a variety of products to consumers through hundreds of thousands of branches, ATM's, loan production offices, and other outlets throughout the United States. These banks are subject to Federal consumer protection statutes such as the Truth in Lending Act, the Truth in Savings Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, and many others. The Federal banking agencies, which are responsible for enforcing compliance with these various consumer protection laws, have been able to fully and effectively enforce compliance with the laws. They have done so through a combination of regular examinations and the threat of enforcement actions. Federal market conduct standards for insurers backed by examinations and the threat of enforcement should work equally well for the consumers of insurance.

In fact, the combination of Federal market conduct standards backed by regular examinations and the potential for enforcement actions should provide insurance consumers better protection than currently exists in many States. The number of consumer complaints filed annually with State insurance commissioners is not a sign of successful State market conduct regulation. Those complaints indicate that something is wrong with State market conduct regulation—otherwise consumers would not need to file so many complaints. The fact is that many States do not conduct market conduct examinations, and this allows insurers and producers who choose to ignore the laws to engage in practices that are harmful to consumers. Federal market conduct standards, regular examinations, and the threat of enforcement actions would effectively deter such harmful practices.

*Access to Uniform Products Benefits Consumers*

Uniform policies and sales practices reduce consumer confusion, especially for those consumers that move from State-to-State for professional or personal reasons. Under an optional Federal chartering system, the same life insurance policy could be offered in every State. Optional Federal chartering also would permit a company to use the same policy form, same disclosure statements, and same administrative procedures throughout the United States.

Uniform regulation also facilitates delivery of insurance products over the Internet. As we all know, the Internet can reach consumers, regardless of where they are located. To date, however, the use of the Internet to deliver insurance products has been complicated by variations in State insurance sales laws. A single Federal sales practice standard would not be subject to such complications. This would expand consumer access to insurance products through the Internet.

*The Dynamic Tension Created by Optional Federal Chartering Benefits Consumers*

The model for optional Federal chartering is the dual banking system. Since the dual banking system has been in place for over 140 years, the best way to judge how optional Federal chartering for insurers and producers would affect consumers of insurance is to take a closer look at the dual banking system.

It is interesting to note that the authors of the dual banking system were President Lincoln and his Secretary of the Treasury, Salmon Chase. After he became President, Lincoln worked with Secretary Chase to secure enactment of the National Bank Act, which provided for the chartering and regulation of national banks.

While there is evidence President Lincoln intended national banks to replace the then existing system of State banks; that has not been the case. Today, approximately two-thirds of all banks are State chartered, and those banks control approximately 40 percent of all banking assets. We are confident the same dynamics prevalent in the banking industry will emerge in the insurance industry. Accordingly, contrary to the concerns of State insurance regulators, in our opinion, optional Federal regulation will not replace State regulation.

In sum, we see no reason to believe that the dynamic tension inherent in a dual regulatory system would not produce a strong supervisory environment for insurance firms and lead to the development of new products and services for insurance customers, just as it has done for the banking industry and banking customers.

**Conclusion**

In conclusion, we urge the Committee to carefully consider the weaknesses of the current State system of insurance regulation and the merits of ABIA's optional Federal insurance chartering proposal. I again thank you for the opportunity to appear here today and if we can be of any further assistance as you consider this issue, I hope the Committee will call upon us.

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## PREPARED STATEMENT OF THOMAS B. AHART

PRESIDENT, AHART, FRINZI & SMITH INSURANCE AGENCY
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

SEPTEMBER 22, 2004

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. 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 a variety of insurance products—property, casualty, health, employee benefit plans, and retirement products.

**Introduction**

At the outset, Chairman Shelby, I must note that IIABA applauds the Committee's interest in this issue as we have many challenges facing the State-based system of insurance regulation. It is our hope that this hearing will be the first step in what promises to be a comprehensive and ongoing process, and we hope we will have the opportunity to present our views at each and every stage of your deliberations on these crucial questions.

IIABA believes it is essential that all financial institutions be subject to efficient regulatory oversight and that they be able to bring new and more innovative products and services to market quickly to respond to rapidly evolving consumer demands. It is clear that there are inefficiencies existing today, and there is little doubt that the current State-based regulatory system should be reformed and modernized. At the same time however, the current system is exceedingly proficient at ensuring that insurance consumers—both individuals and businesses—receive the insurance coverage they need and that any claims they may experience are paid. These and other aspects of the State system are working well. The "optional" Federal charter concept proposed by some would displace these well-running components of State regulation and, in essence, "throw the baby out with the bathwater."

As we have for over 100 years, IIABA supports State regulation of insurance—for all participants and for all activities in the marketplace, and we oppose any form of Federal regulation—optional or otherwise. Yet despite this historic and longstanding support for State regulation, we are not confident that the State system will be able to resolve its problems on its own. That is why we feel that there is a vital legislative role for Congress to play in helping to reform the State regulatory system; however, such an effort need not replace or duplicate at the Federal level what is already in place at the State level. IIABA supports targeted, Federal legislation along the lines of the NARAB provisions of the Gramm-Leach-Bliley Act[1] (GLBA) to improve the State-based system.

To explain the rationale under-girding this approach, I will first offer an overview of both the positive and negative elements of the current insurance regulatory system. I will then outline our opposition to an optional Federal charter. I will then describe the NARAB provisions of GLBA that we feel can serve as a template for further reform. Finally, I will provide a more complete explanation of IIABA's support for the NARAB approach of targeted reforms already proven successful by this Committee.

**The Current State of Insurance Regulation**

From the beginning of the insurance business in this country, it is the States that have carried out the essential task of regulating the insurance marketplace to protect consumers. The current State insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851, and insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved. When a Supreme Court decision raised questions about the role of the authority of the States, Congress quickly adopted the McCarran-Ferguson Act[2] (McCarran-Ferguson) in 1945. That Act, which was reaffirmed by Congress 5 years ago, declared that States should regulate the business of insurance and that the continued regulation of the insurance industry by the States was in the public's best interest.

GLBA expressly states that McCarran-Ferguson remains the law of the United States and further states that no person shall engage in the business of insurance in a State as principal or agent unless such person is licensed as required by the appropriate insurance regulator of such State. Title III also unequivocally provides that "[t]he insurance activities of any person (including a national bank exercising its powers to act as agent . . .) shall be functionally regulated by the States," subject only to certain exceptions which are intended to prevent a State from thereby frustrating the new affiliation policy adopted in GLBA. These provisions collectively ensured that State insurance regulators retained regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. These mandates were intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Most observers agree that State regulation has worked effectively to protect consumers, largely because State officials are positioned to be responsive to the needs of the local marketplace and local consumers. Unlike most other financial products, the purchaser of an insurance policy will not be able to fully determine the value of the product purchased until after a claim is presented—when it is too late to decide that a different insurer or a different product might make a better choice. As a result, insurance is a product with which consumers have many issues and questions and if a problem arises they want to resolve it with a local call. During 2001, State insurance regulators handled approximately 3.6 million consumer inquiries and complaints. Today, State insurance departments employ approximately 13,000 individuals who draw on over a century-and-a-half of regulatory experience to protect insurance consumers.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each State, and the policies themselves are contracts written and interpreted under the laws of each State. When property, casualty, and life claims arise, their legitimacy and amounts must be determined according to individual State legal codes. Consequently, the constitutions and statue books of every State are thick with language laying out the rights and responsibilities of insurers, agents, policyholders, and claimants. State courts have more than 100 years of experience interpreting and applying these State laws and judgments. The diversity of underlying State reparations laws, varying consumer needs from one region to another, and differing public expectations about the proper role of insurance regulation require local officials "on the beat."

Protecting policyholders against excessive insurer insolvency risk is one of the primary goals of insurance regulation. If insurers do not remain solvent, they cannot meet their obligations to pay claims. State insurance regulation gets high marks for the financial regulation of insurance underwriters. State regulators protect policyholders' interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs. The States, through the National Associa-

[1] Previously known as the "Financial Services Modernization Act of 1999."

[2] McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011–1015 (1994)).

tion of Insurance Commissioners (NAIC), have developed an effective accreditation system for financial regulation that is built on the concept of domiciliary deference (the State where the insurer is domiciled takes the lead role). When insolvencies do occur, a State safety net is employed: The State guaranty fund system. The system has paid out over $11 billion to cover claims asserted against insolvent insurers since they were first created in the mid-1970's. States also supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase products and file claims.

Despite its many benefits, State insurance regulation it not without its share of problems. The shortcomings of State regulation of insurance fall into two primary categories—it simply takes too long to get a new insurance product to market, and there is unnecessary duplicative regulatory oversight in the licensing and post-licensure auditing process.

In many ways, the "speed-to-market" issue is the most pressing and the most vexing from both a consumer and an agent/broker perspective because we all want access to new and innovative products that respond to identified needs. Today, insurance rates and policy forms are subject to some form of regulatory review in nearly every State, and the manner in which rates and forms are approved and otherwise regulated can differ dramatically from State-to-State and from one insurance line to the next. Such requirements are significant because they not only affect the products and prices that can be implemented, but also the timing of product and rate changes in today's competitive and dynamic marketplace. The current system, which may involve seeking approval for a new product or service in up to 55 different jurisdictions, is too often inefficient, paper intensive, time-consuming, and inconsistent with the advance of technology and regulatory reforms made in other industries. In order to maximize consumer choice in terms of the range of products available to them, changes and improvements are needed.

Similarly, insurers 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 market-conduct practices, to review mergers and acquisitions, and to outline how the insurer should be governed. It is difficult to discern how the great cost of this duplicative regulatory oversight is justified.

**Federal Chartering**

There is growing consensus among observers, including State and Federal legislators, regulators, and the insurance marketplace—that insurance regulation needs to be updated and modernized. There is disagreement, however, about the most effective and appropriate way in which to obtain needed reforms. Some support pursuing reforms in the traditional manner, which is to seek legislative and regulatory improvements on an ad hoc basis in the various State capitals. A second approach, pursued by several international and large domestic companies, calls for the unprecedented establishment of full-blown Federal regulation of the insurance industry. This call for an optional Federal charter concerns me deeply.

Although the proposed optional Federal charter regulation might correct certain deficiencies, the cost is incredibly high. The new regulator would add to the overall regulatory infrastructure—especially for agents and brokers selling on behalf of both State and federally regulated insurers—and undermine sound aspects of the current State regulatory regime. Agents could be required to obtain an additional license through a bureaucratic Federal agency. As an independent insurance agent, I write for multiple companies, and surely some companies would choose a Federal option while others would continue to be regulated at the State level, which could force me to get dually licensed.

The best characteristics of the current State system from the consumer perspective would be lost if some insurers were able to escape State regulation completely in favor of wholesale Federal regulation. As insurance agents and brokers, we serve on the front lines and deal with our customers on a face-to-face basis. Currently, when my customers are having difficulties with claims or policies, it is very easy for me to contact my local company representative or a local official within the State insurance department to remedy any problems. If insurance regulation is shifted to the Federal Government, I would not be as effective in protecting my consumers, as I have serious reservations that some Federal bureaucrat on a 1–800 number will be as responsive to a consumer's needs as a local regulator. The Federal regulatory model proposes to charge a distant and likely highly politicized Federal regulator with implementation and enforcement. Such a distant Federal regulator may be completely unable to respond to insurance consumer claims concerns. As a consumer, personal or business, there would be confusion as to who regulates their policy, the Federal Government or the State insurance commissioner. I could have a single client with several policies with one company that is regulated at the Federal level, while at the same time having several other policies which are regulated at the State level.

Finally, as I will discuss below, the "consensus" optional Federal charter proposal would require the State guaranty funds to be responsible for insurance companies whose solvency regulation is solely in the hands of a Federal regulator.

**National Association of Registered Agents and Brokers (NARAB)**

One of the most significant accomplishments of GLBA for the insurance marketplace was the NARAB Subtitle, which launched a producer licensing reform effort that continues today. Prior to the enactment of GLBA, each State managed its agent/broker licensing process in a distinct and independent manner, and there was virtually no consistency or reciprocity among the States. For agents and brokers, who increasingly operate in multiple jurisdictions, the financial and paperwork burdens associated with multi-State licensing compliance became overwhelming; and consumers suffered as duplicative and redundant regulatory requirements made it difficult for producers to be responsive to their needs. However, insurance producer licensing has improved dramatically over the last 5 years, and these changes are a direct result of Congress' decision to address these issues.

NARAB put the ball in the States' court by threatening the creation of a new national, NASD-style licensing entity—known as the National Association of Registered Agents and Brokers—if the States did not satisfy the licensing reform objectives articulated by Congress. The creation of NARAB was only averted when a majority of the States and territories (interpreted to be 29 jurisdictions) achieved a specified level of licensing reciprocity within a 3-year period.

To their credit, the NAIC and most States took swift and unprecedented action in response to this "act-or-else" licensing provision. Nearly every State enacted new legislation that established licensing reciprocity among the States and instituted interstate uniformity in certain critical areas. According to the NAIC, at least 48 States have passed licensing reform legislation since the enactment of GLBA, and over 40 jurisdictions have been formally certified as meeting the NARAB mandates. There is no dispute that the NARAB provisions had their intended effect and initiated the move toward agent licensing modernization at the State level. Although more improvement is undoubtedly needed, the States have made significant progress in the 5 years since the passage of GLBA.

The success of the NARAB licensing provisions is a perfect example of what the Federal Government and the States can accomplish in partnership and how Congress can assist the States to achieve much needed marketplace reforms. The NAIC and State policymakers had been trying to move toward reciprocal and uniform licensing for over a century, but little progress was made until Congress set a specific deadline and attached specific goals and repercussions. In fact, Congress set the bar at only a majority of the States and now all but a few have met the NARAB reciprocity standard. This success would not have occurred without targeted Federal legislation, or what some are now calling "Federal tools."

Some may argue that the bar was not set high enough—because uniformity was not required and several States have not adopted the reciprocity standards—but there is no arguing with the provision's effectiveness so far. There is certainly much more to do to get to full agent licensing reciprocity and the ultimate goal of licensing uniformity, but NARAB has set State insurance regulators on the right path, and Congress can now easily move the bar higher in follow-up legislation.

**IIABA's Support for the NARAB Approach of Targeted Reforms**

IIABA supports State regulation of insurance but feels that the system needs to be modernized to bring it into the 21st century. Despite our continued support for the State system, we question whether the States will be able to resolve their problems on their own. For the most part, State reforms must be made by statute, and State lawmakers inevitably face practical and political hurdles and collective action challenges in their pursuit of improvements on a national basis.

Therefore, IIABA believes that Congressional legislative action is necessary to help reform the State regulatory system. We propose that two overarching principles should guide any such efforts in this regard. First, Congress should attempt to fix only those components of the State system that are broken. Second, no actions should be taken that in any way jeopardize the protection of the insurance consumer, which is the fundamental objective of insurance regulation and of paramount importance to the IIABA as our members represent consumers in the insurance marketplace.

IIABA believes the best alternative for addressing the current deficiencies in the State-based regulatory system is a pragmatic, middle-ground approach that utilizes

Federal legislative tools to foster a more uniform system and to streamline the regulatory oversight process at the State level. By using targeted and limited Federal legislation to overcome the structural impediments to reform at the State level, we can improve rather than replace the current State-based system and in the process promote a more efficient and effective regulatory framework. Rather than employ a one-size-fits-all regulatory approach, a variety of legislative tools could be employed on an issue-by-issue basis to take into account the realities of today's increasingly global marketplace. 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. In this way, we can assure that insurance regulation will continue to be grounded on the proven expertise of State regulators at the local level.

Some optional Federal charter proponents argue that using targeted Federal legislation to improve State regulation is more intrusive on the State system than the optional Federal charter model. We strongly disagree. They would have you believe that the optional Federal charter proposals create a parallel universe of Federal-chartered insurers but leave in place the State-chartered system. This is not the case. In fact, to take one example, the so-called industry "consensus" Federal charter proposal would force the State guaranty funds to accept and backstop Federal chartered insurers—there is nothing "optional" about that. This would be an unprecedented intrusion on State solvency regulation. In the end, the State system would be responsible for insolvent insurers but could not regulate them to keep them from going insolvent.

This proposal turns the dual-banking model, which proponents profess to admire, on its head. It is as if the FDIC was turned into 50 State-managed individual deposit insurance corporations, and then these State funds were forced by Congress to insure both national banks and State-chartered banks, but without the States having any supervisory authority over the national banks. The States are clearly left holding the bag under this proposal, which could lead to dysfunction in the insurance marketplace to the detriment of both consumers and companies.

In contrast, a NARAB approach is more deferential of States' rights and is designed to give the leverage to make State and NAIC-developed standards uniform across the Nation. In each substantive area that Congress may choose to address in targeted legislation, a Federal "tool" could provide incentives for the States and the NAIC to develop standards and for the State legislatures or departments to adopt such models. The States could collectively develop the standards that are to become uniform. For example, the consensus choice of the majority of States in each area could become the uniform, required standards in all States. Preemption is only used as a last-resort in most cases. This preserves and builds upon the expertise of State regulation and leaves in place the substantial regulatory force which now protects consumer interests and insurer solvency at the State level. It is the least intrusive option, which unlike "optional" Federal chartering, does not threaten to remove a substantial portion of the insurance industry from State supervision and risk the creation of an unlevel playing field.

Unlike the creation of an entirely new regulatory structure, the enactment of targeted Federal legislation to address certain, clearly identified problems with State regulation is not a radical concept. The Senate Banking Committee and the House Financial Services Committee have already proven that this approach can work with the NARAB provisions of GLBA that we have already discussed. The IIABA believes the NARAB model can serve as a template for further reform of State insurance regulation. The leadership of the House Financial Services Committee has recently decided to take the NARAB approach of "targeted reform" after conducting a 3 year, in-depth review of insurance regulation. We would recommend such an approach to the Senate Banking Committee as well, and look forward to working with the Committee as you continue your review of State insurance regulation and consider possible solutions to modernize the system.

**Conclusion**

IIABA has long been a supporter of reform of the insurance marketplace, working closely with the Senate and House in support of Gramm-Leach-Bliley, the Terrorism Risk Insurance Act of 2002 (TRIA), and more recently supporting an extension of TRIA and the developing consensus for State-based insurance modernization. While GLBA reaffirmed State functional regulation of insurance, some large insurers are now advocating for an "optional" Federal charter. State regulators and legislators, many consumer groups, independent insurance agents and brokers, some life insurance companies, and most property-casualty companies are strongly opposed to an optional Federal charter. In fact, the Property Casualty Insurers Association of America and the National Association of Mutual Insurance Companies which represent property-casualty insurers of all sizes oppose an optional Federal charter. The State system has proven that it best protects consumers and can be modernized to work effectively and efficiently for the entire insurance marketplace with the right pressure from Congress.

Targeted, Federal legislation to improve the State-based system presents Members with a middle-ground solution that is achievable—something we can all work on together. This pragmatic approach would build on the success of the NARAB provisions in GLBA. Because of the Senate Banking Committee's work on NARAB, the vast majority of States have now implemented reciprocal agent licensing. This same approach can be used to get all States moving toward not only reciprocal but also uniform agent licensing, as well as improving other areas of insurance regulation such as State market conduct oversight, company licensing, and product review. We encourage the Senate Banking Committee to take up the mantle of State-based insurance reform and lead this effort. It is a proven a success with NARAB, and is the only solution that can bring the marketplace together to achieve reform.

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## PREPARED STATEMENT OF ALBERT R. COUNSELMAN, CPCU

PAST CHAIRMAN, THE COUNCIL OF INSURANCE AGENTS + BROKERS AND
PRESIDENT & CEO, RIGGS, COUNSELMAN, MICHAELS & DOWNES, INC.

SEPTEMBER 22, 2004

Good morning, Chairman Shelby, Ranking Member Sarbanes and Members of the Senate Banking Committee. 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 Committee today.

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

Riggs, Counselman, Michaels and Downes (RCM&D) is the largest independent agency/brokerage firm in Maryland, with more than 250 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 75th largest insurance/risk management agency in the United States. 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 United States 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 United States and the globe.

### Introduction

RCM&D and the members of the Council of Insurance Agents + Brokers commend you for holding this hearing on the condition and regulation of the insurance industry. Insurance regulatory reform, which is critical for the long-term health of the industry, is long overdue. Modernization of the insurance regulatory structure is an important element in maintaining a strong, vibrant insurance sector. We are very happy to see interest on both sides of Capitol Hill in addressing this issue.

A discussion of the condition of the insurance industry is not complete without addressing the risks posed by terrorism and the importance of the Terrorism Risk Insurance Act (TRIA). The need for Federal action in the area of terrorism coverage is a clear example of the limits of State regulation. Although the State regulators worked diligently in the days and months after the September 11, 2001 terrorist attacks to help to bring stability to the insurance marketplace, it was abundantly clear that they did not have the capacity to act quickly to implement a uniform approach in every State to address the emergency. With the leadership of Senators Bennett and Dodd, and thanks to the hard work of the Members of this Committee and others, TRIA was adopted to provide the backstop necessary to stabilize the insurance markets, and enable construction and real estate projects to go forward and critical, but vulnerable, infrastructure to be insured.

Now, as we look forward to the third and final year of TRIA's current life, the evidence is mounting that TRIA is effective and that purchase of terrorism coverage is increasing. It has also become evident, however, that the private marketplace will not be prepared to take on the full risk posed by potentially catastrophic terrorism losses by the time the law expires on December 31, 2005. Thus, it is imperative that TRIA be extended. The Council thanks Senators Bennett and Dodd for the leadership they have shown by introducing legislation that would accomplish just that. We urge this Committee to ensure that this important piece of legislation becomes law before you adjourn for the term.

I plan to address two main issues in my testimony today:

(i) The Terrorism Risk Insurance Act: Extension of TRIA is critical for consumers/policyholders and for the insurance industry; and

(ii) Insurance regulatory reform: Notwithstanding some improvement in the last few years, there remain significant problems in the State insurance regulatory system; because the States cannot solve these problems on their own, Congressional action will be necessary.

**The Terrorism Risk Insurance Act: Extension of TRIA is Critical for Consumers/Policyholders and for the Insurance Industry**

TRIA has had a huge impact on the availability of insurance and the capacity of insurers to take on risk. The law has successfully brought stability to the private market for terrorism risk insurance, enabling all sectors of the economy to operate on a "business as usual" footing. Without the backstop, the economy could suffer significant damage as businesses pull back because the lack of insurance coverage makes them financially vulnerable. Under TRIA, insurers have the ability to offer terror coverage, thus allowing commercial activity to go forward without threatening the solvency of the parties involved.

TRIA's effect is felt in all corners of the country. Since its enactment, the availability of terrorism coverage has grown and premium prices have dropped. Statistics show that nearly one-half of all insureds now are purchasing terror coverage.

Earlier this year, Marsh, Inc., a member of The Council and one of the top insurance brokers in the United States and internationally, issued a report on the terrorism insurance marketplace based on data collected from its Global Broking centers across the country. The findings indicate that among 15 industries examined, the largest percentage of insureds buying terrorism insurance were in the energy industry. Media, food and beverage, habitational/hospitality, healthcare, and real estate were the other industries with the highest take-up rates. We believe one of the most significant aspects of these findings is that these industries operate across the country—they are not limited to one or two cities or geographic areas—and their products and services are used by all Americans. That is certainly true of the energy industry, which is a critical element of the national infrastructure. TRIA ensures that these industry sectors—which are terrorism targets because of their importance to the country, public safety, and the economy—are able to secure the insurance coverage they need to operate.

Let me give you two specific examples of the importance of TRIA to my firm and our clients:

- One of our clients was building a downtown Baltimore apartment project—located near the Inner Harbor—and the lender required terrorism coverage for the builders risk and for the permanent property coverage. Because of the availability of TRIA, there were several insurers writing in that market. We were able to negotiate with various builders risk insurers, allowing us to provide multiple quotations promptly to the project owner. This gave the owner several competitive choices, rather than forcing the company to "take whatever they could get" in a noncompetitive market—if they could get any coverage at all.
- Another client is a large financial services firm headquartered in a major city. Because of the existence of the TRIA backstop, a leading financial services insurance

provider can offer multiple coverages to this insured, such as property, business income, workers' compensation, and other lines. Without TRIA, however, the insurer would not be able to offer multiple-line coverages. For example, because our client has almost 1,000 employees in a downtown multistory office tower, the insurer likely would not be able to offer the firm workers' compensation coverage. This would force the insured to seek coverage from an insurer that has the capacity to provide such coverage. If there were no insurers with available capacity, the insured may be forced to take significantly higher self-insured retention levels or go into a "State-managed workers' compensation pool." Insurers participating in these assigned-risk pools are "forced" to accept the workers' compensation risk.

When TRIA was enacted, the intent of Congress was to create a short-term Federal backstop to allow insurance markets to gradually assume, and learn to price, terrorism risk—a risk that had previously been insured at no additional cost over the standard policy premium. As TRIA enters the third and last year of its original life-span, it is clear that the capacity of the private market to provide terrorism risk coverage will require more time to fully develop.

A comprehensive and accurate terrorism risk model is necessary for a private terrorism insurance and reinsurance market to take root; development of such a model, however, remains elusive. Risk modeling is a complex and difficult process. Terrorism risk modeling is all the more difficult because of the unique nature of the terrorist threat, the element of human intent, and the limited historical precedents available to provide data for predicting future events.

Terrorism risk models cannot simply follow models for natural catastrophes, which do not involve human intent. To be effective, terrorism risk models need to be based upon:

- where attacks may occur;
- the nature and/or method of attack;
- the probability of a particular type of attack occurring at a specific location; and
- estimated damages that may be inflicted at the location.

In addition to the difficulty in modeling catastrophic terrorism risks, there are several other factors that make such risks uninsurable:

- the insurance sector does not have the capacity to handle truly catastrophic terrorism losses, so another huge terrorism event could financially ruin the commercial property and casualty industry;
- terrorism is an interdependent risk from which no one business or system can protect itself from failure on the part of others;
- information necessary to evaluate terrorism risk is often sensitive intelligence data held by the Government;
- despite the modest amounts of reinsurance available for terrorism coverage, reinsurers will not be able to provide sufficient capacity to the market for terrorism insurance upon TRIA's expiration; and
- alternative financing mechanisms—such as alternative risk pools or catastrophe bonds—currently cannot generate sufficient capacity to deal with catastrophic terrorism risk.

Extension of TRIA must be made a priority. A recent study by Analysis Group, Inc., an economic research firm, says that TRIA helps strengthen the economy's performance by ensuring that commercial business and properties have terrorism risk coverage in place. The report indicates that failure to reauthorize TRIA could result in a $53 billion hit to the U.S. economy even without another terrorist attack. Without the backstop, insurers will reduce capacity for terrorism coverage and impose exclusions on current coverages. The study found that overall GNP would be reduced 0.4 percent without TRIA, total household income net worth would fall by $512 billion, and roughly 326,000 fewer jobs would be created.

The House is scheduled to consider extension of TRIA on September 29, one week from today. We urge you to make every effort to adopt legislation such as S. 2764 extending the program before you adjourn this fall.

**Insurance Regulatory Reform: Notwithstanding Some Improvement in the Last Few Years, There Remain Significant Problems in the State Insurance Regulatory System; Because the States Cannot Solve These Problems on Their Own, Congressional Action will be Necessary**

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

The 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.

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. To that end, The Council's Foundation for Agency Management Excellence (FAME) commissioned an independent study of the economic costs and benefits of the various proposals. Our study, entitled "Costs & Benefits of Future Regulatory Options for the U.S. Insurance Industry," provides an in-depth examination of the pros and cons of the regulatory options available for oversight of the business of insurance. A copy of the study is attached to my testimony.* I hope it will serve as a useful tool as you consider insurance regulatory reforms.

CONTINUING PROBLEMS UNDER THE CURRENT REGULATORY SYSTEM

Although the States have made some strides in recent years in simplification and streamlining regulatory requirements, almost all the concrete progress has been in the producer licensing area—thanks to the enactment of the NARAB provisions included in the Gramm-Leach-Bliley Act (GLBA). NARAB-compliance notwithstanding, there remain several problem areas in the interstate licensing process that impose unnecessary costs on our members in terms of time and money. In addition, insurance companies face problems 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. The operation of and access to alternative markets—such as surplus lines and risk retention groups—is also hampered by unnecessarily cumbersome and duplicative regulatory requirements. These continuing problems with the State-by-State insurance regulatory process has lead us to the following conclusion: Regulatory relief is needed, and it is needed now.

*Producer Licensure: Welcome Improvements, but Incomplete Reform*

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

After enactment of GLBA, the NAIC pledged not only to reach reciprocity, but also, ultimately, to establish uniformity in producer licensing. The regulators amended the NAIC Producer Licensing Model Act (PLMA) to meet the NARAB reciprocity provisions, and their goal is to get the PLMA enacted in all licensing jurisdictions. As of today, 47 States have enacted some licensing reform and the NAIC has now officially certified that a majority of States have met the NARAB reciprocity requirements, thereby averting creation of NARAB. This is a good effort, but the problems are in the details; there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions.

Although most of the States have enacted the entire PLMA, 4 States have enacted only the reciprocity portions of the model. Of the States that have enacted the entire PLMA, there are several that have deviated significantly from the model's original language. One State has enacted licensing reform that in no way resembles the PLMA. And two of the largest States in terms of insurance premiums written, Florida and California, have not enacted legislation designed to meet the NARAB reciprocity threshold at all.

The inefficiencies and inconsistencies that remain in producer licensing affect every insurer, every producer, and every insurance consumer. As for my own firm, we hold 161 resident licenses in Maryland and Virginia, and 332 nonresident licenses across the country, up from 175 nonresident licenses in 1999. We not only had to secure initial licenses, but we face also annual renewals for those nearly 500 licenses in 50+ jurisdictions, in addition to satisfying all the underlying require-

* Held in Committee files.

ments 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.

In addition to the lack of full reciprocity in licensing procedures for nonresidents, the standards by which the States measure compliance with licensing requirements differ from State-to-State, as well. These include substantive requirements—prelicensing education, continuing education, and criminal background checks, for example—as well as administrative procedures such as agent appointment procedures and license tenure and renewal dates. While these may seem like small issues, they can easily turn into 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. In addition to the day-to-day difficulties the current set-up imposes, this inconsistent application of law among the States inhibits efforts to reach full reciprocity. Some States may be disinclined to license as a nonresident a producer whose home State has "inferior" licensing standards, even a State with similar or identical statutory language. In fact, several States that have failed to adopt compliant licensure reciprocity regimes claim that their refusal is based on this absence of uniform standards—thus implying that the standards of other States do not measure up.

A third major area in need of streamlining is the processing of license applications. Although a uniform electronic producer licensing application is now available for use in many States—arguably, the biggest improvement in years—several States, including Florida and South Carolina, do not use the common form, and in States that use the form there is no common response mechanism. Each State follows up on an application individually, which can be cumbersome and confusing. Our attempts to renew licenses in the District of Columbia last year offer an egregious example of this failure of forms and processing. Although renewal applications were submitted in April 2003, approval of the final renewal was not received until February of this year, after many attempts to follow-up.

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 are capable of fully satisfying those goals. Indeed, until recently, the State of Florida completely barred nonresidents from being licensed to sell surplus lines products to Florida residents or resident businesses. The State required nonresident 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. Similarly, the U.S. Court for the District of Nevada ruled from the bench in The Council's favor on its challenge to analogous countersignature requirements in Nevada; the formal judgment has not yet been issued. West Virginia, facing a similar lawsuit initiated by The Council, repealed its countersignature requirements. The Council's suit challenging South Dakota's countersignature law is still pending.

*Speed-To-Market*

The State-by-State system of insurance regulation gives rise to problems outside the area of producer licensing that require immediate Congressional attention, as well. Although these problems appear to affect insurance companies more than insurance producers, the unnecessary restraints imposed by the State-by-State regulatory system on insurers 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 sector of the insurance industry is facing severe challenges today due to a number of factors, including: The losses incurred as a result of the September 11 terrorist attacks; increased liability expenses for asbestos, toxic mold, D&O liability, and medical malpractice; and years of declining investment returns and consistently negative underwriting results. Some companies have begun to exit insurance markets as they realize that they can no longer write these coverages on a break-even basis, let alone at a profit. The end result is increased prices and declining product availability to consumers. This situation is exacerbated by the current State-by-State system of insurance regulation.

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

It is also important to note that insurers wishing to do business on a national basis must deal with 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 preapproval requirements still in use in many States. Over a dozen States have completely deregulated 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 preapproval requirements, significantly impeding the ability of insurers to get products to market. Indeed, some studies have shown that it can take as much as 2 years for a new product to be approved for sale on a nationwide basis. Banking and securities firms, in contrast, can get a new product into the national marketplace in 30 days or less. The lag time for the introduction of new insurance products is unacceptable. It is increasingly putting the insurance industry at a competitive disadvantage as well as undermining the ability of insurance consumers to access products that they want and need.

Let me give you an example that all Council members are familiar with: A few years ago, PAR, an errors and omissions captive insurer sponsored by The Council, sought to revise its coverage form. In most States, PAR was broadening coverage, although in a few cases, more limited coverage was sought. PAR had to 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 for 65 sophisticated policyholders is unacceptable and is symptomatic of the problems caused by outdated rate and form controls.

We support complete deregulation of rates and forms for commercial lines of insurance. There is simply no need for such Government paternalism. Commercial insureds are capable of watching out for their own interests, and a robust free market has proved to be the best price control available.

*Access To Alternative Markets*

In the last 2 years, high rates for property and casualty insurance have been a serious problem for many mid-sized and larger commercial firms. Hard markets such as these cause availability to decrease and the cost of coverage to increase. During these periods, insureds—particularly sophisticated commercial insureds—are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage options and hold down costs. There are two excellent mechanisms in place that offer such alternative markets: Surplus lines insurance and risk retention groups. Although surplus lines insurance and insurance purchased through risk retention groups technically are less regulated than insurance in the admitted market, there are, nonetheless, State regulatory requirements—and Federal laws—that apply to these alternative market mechanisms. As described more fully below, updating these regulations and laws and encouraging use of alternative insurance markets would help to increase options and decrease costs for insurance consumers.

*Surplus Lines.* For commercial property and casualty insurance, business is done increasingly through the surplus lines marketplace. A surplus lines product is an insurance product sold by an insurance company that is not admitted to do business in the State in which the risk insured under the policy is located. 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 insurance company is located to purchase the coverage. The insurer may be in another State, or it may be in Great Britain, Bermuda, or elsewhere. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers.

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

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 percent 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(s).
  - 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 require that a surplus lines insurer be deemed "eligible" by meeting certain financial criteria or having been designated as "eligible" on a State-maintained list. 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 multi-State surplus lines coverage is placed with an insurer that is an admitted (not surplus lines) insurer licensed in one of the States in which part of the risk is located. This is problematic because surplus lines insurance cannot be placed with a licensed insurer. In these situations, more than one policy will have to be used, or the insured will have to use a different surplus lines carrier.
- 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.

*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 1970's. The current version of the law—the Liability Risk Retention Act of 1986—was enacted in response to the "hard market" of the mid-1980's and expanded the coverage of the Act to all commercial liability coverages. Risk Retention

Groups (RRG's) 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; RRG's may only write commercial liability coverages and only for their member-insureds.

The rationale underlying the single-State regulation of RRG's 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."

SOLUTIONS—CONGRESSIONAL LEADERSHIP AND ACTION IS CRITICAL IF INSURANCE REGULATORY REFORM IS TO BECOME A REALITY

The FAME study notes that all the regulatory modernization efforts attempted by the NAIC in the past several years have been the direct result of major external threats—either the threat of Federal intervention, or the wholesale dislocation of regulated markets. The study concludes that there is no guarantee the State-based system will adopt further meaningful reforms without continued external threats to the States' jurisdiction, and it offers the progress on producer licensing reform as a prime example. The Council wholeheartedly agrees with this conclusion. Too much protectionism and parochialism interferes with the marketplace, and the incentive for reform in individual States simply does not exist without a Federal threat. Thus, Congressional involvement in insurance regulatory reform is entirely in order and, in fact, overdue.

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 allow the industry to operate more efficiently, to enable the insurance industry to compete in the larger financial services industry and internationally, and to provide consumers with a strong, competitive insurance market that brings them the best product at the lowest cost.

As we all know, there are, essentially, two approaches to insurance regulatory reform currently under consideration—the "roadmap" that addresses reform issue-by-issue and the optional Federal charter. These approaches, although different, are not necessarily mutually exclusive—partial reform now does not rule out further reform in the future.

The "roadmap" approach being developed by House Financial Services Committee Chairman Mike Oxley (R-OH) and Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee Chairman Richard Baker (R-LA), lays the groundwork for aggressive reforms that will provide 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. The proposal would go a long way toward resolving many of the most deep-seated insurance regulation problems, particularly with respect to the producer issues that are of specific concern to Council members. The Oxley-Baker proposal would build on the NARAB template, expanding reciprocity requirements to all 50 States, and requiring uniform licensing standards—including criminal background checks—in every State, resulting in the first truly seamless, national insurance producer licensing system.

The Oxley-Baker proposal is a comprehensive plan that, in addition to producer licensing, addresses the spectrum of insurance regulatory issues. It would resolve the surplus lines market access issues by updating and streamlining the current dysfunctional semi-regulatory process; it addresses speed to market problems caused by unnecessarily cumbersome rate and form regulation; and it attacks a number of other insurance regulatory issues that are dealt with in patchwork fashion by the States, including market conduct, company licensing, and life insurance matters.

The roadmap proposal could prove to be a huge step on the road to insurance regulatory reform. Having said that, however, we believe the ultimate solution—at least for the property and casualty industry—is enactment of legislation creating an optional Federal insurance charter. An optional Federal charter would give insurers and producers the choice between a single Federal regulator and multiple State regulators. It would not dismantle the State system, rather it would complement the State system with the addition of a Federal partner. It is likely that many insurers and producers—particularly those who operate in a single State or perhaps a small number of States—would choose to remain State-licensed. Large, national and international companies, on the other hand, would very likely opt for a Federal charter, thereby relieving themselves of the burden of compliance with 51 different regulatory regimes.

I am encouraged to hear that Senators Sununu (R-NH) and Carper (D-DE) are developing optional Federal charter legislation. The Council has been a strong advocate for such legislation for a number of years, and we look forward to working with all of you to develop the proposal from concept into reality. Realistically, we understand that it could take several years for optional Federal charter legislation to be enacted. It is a major undertaking with a great number of issues to be resolved. Political reality dictates that it will not be an easy process, nor will it be quick. Let me be clear that The Council is in this for the long haul. We will work with you until our common goal is reached. Between now and then, however, insurance regulation is in desperate need of reform. In order to better serve our policyholders and clients, we need practical solutions to real marketplace problems. We believe the Oxley-Baker proposal provides those practical solutions and, by streamlining and updating critical insurance regulatory processes, will set the stage for creation of an optional Federal charter.

In closing, as I noted above, improvements in the State insurance regulatory system have come about largely because of outside pressure, notably, from the Congress. Despite its ambitious reform agenda, the NAIC is not in a position to force dissenting States to adhere to any standards it sets. Thus, it is clear that Congressional leadership will be necessary to truly reform the insurance regulatory regime in the United States. On behalf of The Council, I thank you for your genuine interest in fixing this important piece of our financial infrastructure. I also thank Chairman Shelby and Senator Sarbanes for their leadership in this area. Your attention to this critical issue is heartening. We stand ready to assist you in any way that we can to advance this important effort.

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## PREPARED STATEMENT OF BRIAN K. ATCHINSON

EXECUTIVE DIRECTOR, INSURANCE MARKETPLACE STANDARDS ASSOCIATION

SEPTEMBER 22, 2004

### Introduction

Good morning, Chairman Shelby and Members of the Committee. Thank you for the opportunity to speak to you today on the Examination and Oversight of the Condition and Regulation of the Insurance Industry.

I am Brian Atchinson, Executive Director of the Insurance Marketplace Standards Association (IMSA). IMSA is an independent, nonprofit organization created in 1996 to strengthen consumer trust and confidence in the marketplace for individually sold life insurance, annuities and long-term care insurance products. We encourage you to visit our website (*www.IMSAethics.org*) to learn more about IMSA.

IMSA members comprise more than 160 of the Nation's top insurance companies representing nearly 60 percent of the life, annuities, and long-term care insurance policies written in the United States. The IMSA Board of Directors is comprised of chief executive officers from IMSA-qualified companies as well as experts and professionals from outside the insurance industry. To attain IMSA qualification, a life insurance company must demonstrate its commitment to high ethical standards through a rigorous independent assessment process to determine the company's compliance with IMSA's Principles and Code of Ethical Market Conduct.

As a former regulator and company person, my views on the regulation of insurance are based upon a number of different vantage points. From 1992–1997, I served as Superintendent of the Maine Bureau of Insurance. From 1994–1997, I represented U.S. regulators in the International Association of Insurance Supervisors and in 1996, I served as President of the National Association of Insurance Commissioners (NAIC). Prior to joining IMSA, I served as an executive officer in the life insurance industry.

### Ethical Standards in a Competitive Financial Services Marketplace

Life insurers face increasingly intense market competition from other providers of financial service products both domestically and internationally. In this challenging environment, it is important that financial service providers follow high ethical standards to best protect and serve consumers and to make sure the marketplace remains strong.

In the United States, IMSA develops ethical standards for the life insurance industry. To our knowledge, there is no similar organization in this country for financial services sectors dedicated to promoting ethical standards and practices.

In an era when the practices of some financial services companies have come under media and public scrutiny, IMSA continues to provide clear ethical leadership. Our Principles of Ethical Market Conduct, to which all IMSA-qualified companies must adhere, include requirements for the marketing, advertising, sales and customer service of annuities, long-term care and life insurance. (See attached Principles.)* IMSA's Principles also contain a "needs-based" selling standard. We believe that all consumers—including our military service men and women—should receive clear and honest information before they purchase any type of insurance product.

IMSA's standards have received favorable recognition internationally as well. A recent *Financial Times* article regarding the "Restoring Trust" report on the UK's financial services industry cited IMSA as a successful example of a principles-based, industry-led approach to raising ethical standards. As competition in the financial services sector grows, ethical standards for all financial services providers, not just life insurers, could improve marketplace practices.

**The Changing Role of Market Conduct Regulation**

Insurance regulation is intended to ensure a healthy, competitive marketplace, to protect consumers, and create and to maintain public trust and confidence in the insurance industry.

An integral component of insurance regulation is the appropriate oversight of the ways insurance companies distribute their products in the marketplace, namely, market conduct regulation.

The history of market conduct regulation goes back to the early 1970's when the NAIC developed its first handbook for market conduct examinations and did its first market conduct investigation. We've come a long way—by 2002, departments reported a total of 1,333 market conduct exams and 465 combined financial/market conduct exams.

Yet as the Government Accountability Office noted in a report issued last year, there has been little consistency or uniformity in the way individual States perform market conduct oversight. For example, each company writing business nationally must comply with dozens of widely divergent State and Federal standards regarding the replacement of policies. There are no logical reasons for so many different and inconsistent standards or to impose those extra and superfluous costs on companies and consumers.

The State-based system of market conduct regulation has been in need of improvement and updating for some time. Until a consistent, nationwide system of market regulation can be established, insurers will continue to be subject to simultaneous or overlapping market conduct examinations from different States applying different laws and regulations—while consumers in some States receive little market conduct protection, as documented in the GAO study. This lack of uniformity places significant costs and human resource burdens upon insurance companies that translate into higher costs that are ultimately passed on to consumers in the form of higher prices for their products.

**Making Market Conduct Regulation More Efficient**

The challenge for the future is to create a uniform system of market conduct oversight that creates greater efficiencies for insurance companies while maintaining appropriate consumer protections.

There has been some progress toward a more efficient system of market regulation and IMSA has been an active participant in these efforts. We commend the NAIC for its willingness to explore ways that regulators and best practices organizations can work collaboratively to improve market conduct regulation and advance the interests of consumers.

IMSA has worked closely with the NAIC in a variety of areas, including its recently completed a 2-year study of best practices organizations such as IMSA. We commend State insurance regulators for pursuing a new market analysis approach to regulation that will hopefully reduce inefficiencies and better allocate resources to provide more comprehensive consumer protections. While this represents a step forward, the framework to implement this type of analysis remains under development.

In addition, IMSA was involved in development of the NAIC/NCOIL Model Law on market surveillance that promotes market analysis and greater use of insurer self-evaluative activities such as those required under IMSA standards to introduce a more uniform and efficient regulatory scheme.

IMSA has responded to requests to provide information to the House Committee on Financial Services for its draft of the State Modernization and Regulatory Transparency Act (SMART Act), which encourages State regulators to collaborate with best practices organizations such as IMSA. By introducing a uniform set of national

* Held in Committee files.

standards for market conduct regulation and collaborating with best practices organizations, all consumers can be assured that every insurer will be subject to some degree of oversight.

Establishing a uniform system of market analysis in cooperation with best practices organizations would allow regulators to focus on whether an insurer has a sound market conduct and compliance infrastructure in place to better protect consumer interests. Today's market conduct examinations tend to focus on technical instances of noncompliance rather than exploring whether a company has a comprehensive system of policies and procedures in place to address market conduct compliance issues. Uniform national market analysis also would establish a more efficient and effective regulatory process that would eliminate unnecessary duplicative costs and the administrative burdens of the current system that are ultimately passed on to consumers.

**Response to Market Conduct Challenges**

IMSA's mission is primarily to strengthen trust and confidence in the life insurance industry through commitment to high ethical market conduct standards. IMSA qualification also provides a consistent uniform template of market conduct compliance policies and procedures at all IMSA member companies. To become IMSA-qualified, an insurer voluntarily undergoes an internal assessment of their existing policies and procedures to determine whether they comply with IMSA standards. Then an independent assessor reviews those policies and procedures to determine that a comprehensive system of compliance exists throughout the company.

Insurers that qualify for IMSA devote considerable resources to maintaining IMSA's standards. These companies also are well-positioned to respond quickly and effectively to State market conduct inquiries and to comply swiftly with new Federal or State requirements.

In the last 2 years, IMSA has gained greater acceptance by regulators, rating agencies, and others. A growing number of State insurance departments use a company's IMSA qualification as a tool when planning and conducting market analysis activities. We applaud these efforts and would like to see more State insurance departments using IMSA information to create greater efficiencies in the market conduct regulatory process. During a period of time in which State insurance department budgets are often under pressure, we encourage regulators to pursue all appropriate means to leverage limited regulatory resources.

IMSA continually strives to meet the needs of consumers, companies, and the marketplace as a whole by helping its member companies develop and refine an infrastructure of policies and procedures designed not just to detect but to also resolve questionable marketing, sales, and distribution practices before they become more widespread.

Consumers should be able to expect honesty, fairness, and integrity in their insurance transactions. Neither regulators nor companies alone can ensure the marketplace is always operating in a fair and appropriate manner at all times. Organizations like IMSA, working collaboratively with regulators, can offer invaluable support for a healthy competitive marketplace and to enhance market conduct regulation.

**Conclusion**

The financial services marketplace is becoming increasingly competitive for life insurance companies. To be able to bring products to market and conduct their operations in an efficient manner, the life insurance industry, as represented by IMSA member companies, believes market conduct regulation should be more uniform and efficient. IMSA-qualified companies stand as the benchmark for excellence in the life insurance industry and can serve as a valuable resource to help regulators implement true market regulation reform.

IMSA will continue to work with you and State and Federal officials to improve market conduct regulation for the benefit of consumers, regulators, insurers, and insurance professionals alike. I would like to thank the Members of this Committee for examining this crucial topic and for the opportunity to share my perspectives on this important issue.

**RESPONSE TO A WRITTEN QUESTION OF SENATOR CRAPO FROM ARTHUR F. RYAN**

**Q.1.** Some have suggested to this Committee that the privacy notice required by the Gramm-Leach-Bliley Act is overly confusing and largely ignored by consumers. Would you please briefly describe your experience with the privacy notice requirement and what, if any, recommendations you have for us?

**A.1.** Our experience with the privacy notice required under the Gramm-Leach-Bliley Act (GLBA) suggests that this is not an area of particular concern for Prudential's customers. Further details of our experience are described below. If, however, Congress determines that modifications are called for, we would strongly encourage the Committee to consider a Federal preemption of State law as modifications are discussed.

Prudential sends customers an initial and annual GLBA privacy notice, as required by Federal and State law. The notice describes how we handle customer information, including the sharing of certain information with affiliates and a joint marketing partner (we do not, however, share information with other third parties for marketing-related purposes). Prudential's privacy notice also describes how we protect personal information about our customers—and offers customers' choices to consider, including how to "opt out" of sharing their information with our affiliates and joint marketing partner. In fact, two opt out methods are available (a tear-off coupon that customers can complete and mail back to us, or a toll-free telephone number they can call to opt out).

We sent more than eight million GLBA privacy notices to our customers in the first 9 months of 2004. Of that number, 129,665 individuals returned coupons or called the toll-free number to opt out of information sharing. More than half of those responses had comments or questions in addition to the opt out request. The overwhelming majority of responses were related to products customers have with us (for example, requests for address changes and inquiries about product status).

A very small segment of the responses received were related the notice itself. Some of the most common were, "Why am I getting this every year?" and "Am I still opted out?" To date, approximately 150 customers have expressed opinions about the notice wording or content (comments including that the notice was "difficult to read," in "legalese" or that it was "long winded"). Since these comments represent fewer than 20 notices for every million notices mailed, and this rate is consistent with our experience in previous years, we feel that it is fair to conclude that our customers are not "overly confused" by our GLBA privacy notice. While this data would suggest to us that Congress need not take action regarding the language of GLBA notices, if Congress determines that modifications are called for, we would strongly encourage the Committee to consider a Federal preemption of State law.

The insurance industry is unique in its regulatory structure, in that we are regulated extensively in all the States in which we do business. Thus, when Congress assigned GLBA enforcement to the "functional regulators," in the case of insurance, authority resided with each State's insurance regulator. Most States responded by promulgating rules based on the NAIC *Privacy of Consumer Finan-*

*cial and Health Information Model Regulation,* which has been generally consistent with the Federal banking and securities rules, or by enacting State law with GLBA-like provisions. Consequently, financial institutions have been able to send customers a single notice, regardless of product or jurisdiction.

We are concerned that without preemption of State law, States will adopt varying standards, which will ultimately result in insurance products and services being subject to multiple notice requirements. This concern is particularly acute regarding variable life insurance and variable annuity products that are regulated for GLBA purposes by both State law and SEC Regulation S–P. It is only with diligent effort and extraordinary luck that we have been able to avoid such a result thus far, and there is no assurance that we could successfully modify the notice requirements of 50 States to conform to changes in Federal requirements. In fact, since some States adopted the GLBA notice requirements legislatively, and some of those legislatures meet only once every 2 years, it is likely that notice requirements could actually conflict if Congress were to modify the notice requirements without preemption.

Allowing two separate sets of notice requirements to be in place—one Federal and one State—seems almost certain to cause exactly the kind of consumer confusion that is the basis for Congress' current concern about the notice language. Therefore, if Congress decides to modify the GLBA notice requirements, we strongly recommend that it preempt State law on that subject as part of the modification.

**RESPONSE TO A WRITTEN QUESTION OF SENATOR CRAPO FROM WILLIAM H. MCCARTNEY**

**Q.1.** Some have suggested to this Committee that the privacy notice required by the Gramm-Leach-Bliley Act is overly confusing and largely ignored by consumers. Would you please describe you experience with the privacy notice requirements and what, if any, recommendations you have for us?

**Q.1.** *Are notices overly confusing?* Privacy notices are confusing to many consumers. The specific reasons for this are discussed below, but we believe the legal requirements and the complexity of the issue drive this confusion.

*Are notices largely ignored by consumers?* We find that consumers are not as interested in the privacy practices of a financial institution as they are in the price of the product and reputation of the company. While we have a small minority of customers who are very vocal about privacy issues and contact us to share their thoughts, the overwhelming majority seem to have made up their minds to trust a financial institution based on brand, reputation, and past experience before acquiring a product. Consumers tend to make their opt out choice based on their overall trust of the company or their general position on privacy issues rather than on the content of privacy notices. Once consumers have made the decision to place their trust in a company, the privacy notice becomes almost immaterial to many of them. Many of our customers reported feeling flooded with notices, indicating that they are getting more far more detailed information on this topic than they want, and are receiving more notices than they believe they need.

*USAA experience.* USAA has a very low opt out rate. Many of our customers have indicated that they have filed opt outs with other companies with which they do business, but not with USAA, because they trust us and assume we will use their information appropriately. According to Forrester Research, USAA received the highest score among all financial services companies as an advocate for its customers.

*Recommendations.* We have several recommendations for improving privacy notices.

- *State and Federal privacy laws should be consistent.* Consistency should apply across all types of financial institutions. In several States we have to send multiple notices in order to meet the standards under Federal and State laws. This results in confusion to consumers when they receive multiple privacy notices from the same family of companies with different information and different choices. We believe the only way to remedy this is to amend GLBA to preempt State regulation of financial institution information sharing practices and notice requirements.

  *Reduce the information that is required to be in a GLB privacy notice.* Privacy notices are required to include information about practices that are not affected by an opt out. This is confusing to consumers and misleads them with regard to the scope of the opt out. It results in too much information for consumers to wade through to get to essential information about their opt out, as well as the consequences of exercising an opt out.
- Part of the reason that notices are too long is because the Federal regulations added requirements that were not in GLBA.
- *Reduce the frequency of notices.* One reason that consumers ignore privacy notices is that they receive so many notices. One solution would be to reduce the frequency of notices. After providing a consumer with the initial notice, no further notice should be required for 5 years, provided the initial notice is still accurate as to that customer. This would be consistent with the timing under FACTA.
- *Constitute an advisory group with representatives from the financial services industry, the regulatory community, leading privacy experts, and consumers to recommend new, simpler standards.* Some work in this area has already been done through the FTC workshop, the Treasury Department study on information sharing practices and informal working groups.

Thank you for the opportunity to comment on this important issue. USAA is dedicated to protecting the privacy of our members and to making it as efficient as possible for them to do business with us. Privacy notices should be simple and privacy laws should not make it more difficult for consumers to transact business with companies they have already decided to trust as their provider of financial services.

**United States Senate**
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

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*For Immediate Release:*
*September 22, 2004*

## SENATE BANKING COMMITTEE LEADERS SEEKING INQUIRY INTO MARKETING AND SELLING OF FINANCIAL PRODUCTS TO MILITARY PERSONNEL AND THEIR FAMILIES

The Chairman and Ranking Member of the Senate Banking, Housing, and Urban Affairs Committee today asked the Comptroller General of the United States to investigate the way in which financial products are being marketed and sold on-base to military personnel and their families. The letter by Senator Richard Shelby (R-AL) and Paul S. Sarbanes (D-MD) is in response to recent allegations about how financial products, such as life insurance and investment vehicles are being marketed on military bases to service members and their families.

The text of the letter to the Comptroller General of the United States follows:

September 22, 2004

The Honorable David M. Walker
Comptroller General
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Walker:

Recently, concerns have been raised regarding the financial vulnerabilities that service members and their families may face. Specifically, it has been alleged that financial products, such as life insurance and investment vehicles, are being marketed to service members on U.S. military facilities in response to those vulnerabilities. Such products may be marketed to service members by organizations that may receive special access to military personnel. Questions have also been raised about the extent to which securities and insurance regulators have jurisdiction over the sale of these products and also about the ability of military authorities to adequately oversee the sales of such products.

Accordingly, we request that the Government Accountability Office (GAO) research the manner in which financial products are marketed and sold to service members on U.S. military facilities. Specifically, we would like GAO to assess the regulatory oversight associated with the marketing and sale of financial products to service members on military installations (U.S. and abroad), and compare the regulatory oversight and consumer protections afforded to military personnel to those protections afforded to the general public. Finally, please provide an assessment of the accessibility that military personnel have to a full range of financial products on U.S. military installations, and, to the extent possible, assess the quality of such products.

Sincerely,

Richard Shelby
Chairman

Paul S. Sarbanes
Ranking Member

## STATEMENT OF THE AMERICAN LAND TITLE ASSOCIATION

SEPTEMBER 29, 2004

On behalf of the membership of the American Land Title Association (ALTA),* we commend you for undertaking "Examination and Oversight of the Condition and Regulation of the Insurance Industry" We ask that you include this letter in the hearing record on that issue.

Congressional review of the State insurance regulatory system is an important accomplishment. We applaud the time and effort that has gone into analysis of the strengths and weaknesses of the current State product approval, rate setting, and consumer protection programs. The attempt by the Senate Banking Committee to undertake a review of the areas where uniformity would increase the efficiency of the Nation's insurance system while maintaining consumers' access to products and the consumer protections inherent in the current State regulatory system is admirable. We also note that the Senate heard from many insurance entities that an optional Federal charter for insurance companies would have many benefits.

At this point, based on what we know of the concepts of optional Federal charter and proposals discussed by Chairman Mike Oxley and Subcommittee Chairman Richard Baker in the House Financial Services Committee, we prefer the approach discussed in the House of Representatives. We wanted to alert you that as you move forward and draft legislation, you should keep in mind the wide variety of business models in the title insurance industry. In fact, we are writing to officially express our concerns and hope that we are excluded from legislation that establishes a national licensing system for agents and brokers. In fact, it may be easier and preferable to exclude title insurance from most provisions of this legislation as was done when the National Association of Registered Agents and Brokers (NARAB) was created as part of Gramm-Leach-Bliley. We look forward to reviewing any legislative proposals for their potential effect on our industry. And, we stand ready to assist you as you move forward in this process.

ALTA represents title insurance and settlement service providers. Of all the lines of insurance, none are as inextricably linked to State and local conditions as the title insurance industry. The focus of title insurance is the protection of the interests of owners, investors, lenders, and others in real estate. The underwriting of title insurance involves a review and assessment of State and local records affecting titles to real estate. Title insurance policies are issued in connection with inherently local transactions—real estate settlements and mortgage loan closings. Reflecting the diversity of State and local laws as well as the variety of local practices regarding real estate, the processes by which title insurance is issued will frequently vary from State-to-State, and even from region-to-region within a State.

Because title insurance underwriting is so State specific, and because specific legislative language allowing us to determine the effect on the industry is not yet available for review, ALTA and its members strongly believe that regulation of the title insurance industry should continue to be the province of the various States. Uniform licensing of insurance companies may be unnecessary given the small number of companies that underwrite the title insurance product. Nearly 50 percent of the industry volume is written in four States, where title insurance companies are highly regulated and have stringent consumer protections. Solvency issues are best addressed at the State level. In fact, title insurance companies are so well-regulated at the State level that only one State—Texas—has a State guaranty fund.

Uniform licensing of title agents would be counterproductive. There are various types of agents through which title insurance is provided in different States and regions of the country, a variety of State real property laws, and a need for each such agent to be intimately familiar with its own unique State real property statutes. Any Federal regulation of agents should set standards as high as current State law requirements. In many areas of the country, title insurance is provided through attorneys, who perform the title and legal and advocacy work associated with commercial and residential real estate settlements. Attorneys are licensed and disciplined through their State bar associations and could be expected to object vehemently object to National licensing supervision. It would make little sense to require federally licensed title insurance agents doing business in Ohio to learn South Carolina real property law, and an enormous undertaking for a Federal agency to establish Fed-

*The American Land Title Association membership is composed of 2,400 title insurance companies, their agents, independent abstracters, and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in titles. Many of these companies also provide additional real estate information services, such as tax search, flood certification, tax filing, and credit reporting services. These firms and individuals employ nearly 100,000 individuals and operate in every county in the country.

eral regulations that would reflect variations in the real property law of the 50 States. In fact, title insurance was excluded from coverage under the NARAB authorized in the Financial Services Modernization Act because of these issues.

With respect to consumer claims, ALTA believes that problems that arise with insureds are best handled at the State level. Title claims relate to the specific real property involved. It is unlikely that Federal agencies would be in a better position to remedy these specific problems than local courts. Further, some title problems are solved through such methods as remedying foreclosures that reflect State specific law. Again, this is an area where State regulators have great expertise. We look forward to working with the Committee and the Subcommittee on these and other issues as the legislative process proceeds.