IMPROVING INSURANCE FOR CONSUMERS—INCREASING UNIFORMITY AND EFFICIENCY IN INSURANCE REGULATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCE AND HAZARDOUS MATERIALS

OF THE

COMMITTEE ON COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

SEPTEMBER 19, 2000

Serial No. 106–155

Printed for the use of the Committee on Commerce

U.S. GOVERNMENT PRINTING OFFICE
67–117CC WASHINGTON : 2000

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IMPROVING INSURANCE FOR CONSUMERS—INCREASING UNIFORMITY AND EFFICIENCY IN INSURANCE REGULATION

TUESDAY, SEPTEMBER 19, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:14 a.m., in room 2123, Rayburn House Office Building, Hon. Michael G. Oxley (chairman) presiding.

Members present: Representatives Oxley, Gillmor, Ganske, Shimkus, Towns, Barrett, Luther, Rush, and Dingell, (ex officio).

Staff present: Robert Gordon, majority counsel; Yong Choe, legislative clerk; and Bruce Gwinn, minority professional staff.

Mr. OXLEY. The subcommittee will come to order.

The Chair will recognize himself for an opening statement.

Last July, this subcommittee held a hearing on improving insurance for consumers, increasing uniformity and efficiency in insurance regulation. We received a statement of intent from the National Association of Insurance Commissioners signed by all of the insurance commissioners detailing their commitment to achieving uniformity. NAIC President George Nichols, who is with us today, also committed to following through with concrete and measurable steps toward achieving that reform by the time of today's hearing.

On our first panel I am pleased to have testifying a rising star in the insurance industry, the Honorable J. Lee Covington, Director of the Ohio Department of Insurance. Lee has helped spearhead the Commissioner's work to modernize our insurance regulatory system and agreed to join us today to report back on the NAIC's efforts. By all accounts, the NAIC has in fact made significant progress; and I would like to thank in advance both Commissioner Lee and President Nichols for their outstanding work.

A reform in Glass-Steagall took Congress over 65 years to achieve, and I recognize that modernizing insurance reform will not happen overnight. Unfortunately, however, the NAIC in the past has too often been accused of talking the talk but not walking the walk. While I continue to fully support the NAIC's work, I hope that we can keep reform efforts at an expedited pace. I don't think the ranking member and I have 65 years to invest in that.

I challenge both the States and the industry to work toward December of this year to put into action the first plans for achieving uniformity of insurance regulation, with comprehensive reform efforts following soon thereafter. This will mean the Congress and the State legislatures will have to work closely together with the insurance commissioners to forge the reforms and to be prepared to act swiftly on implementation once a consensus is reached. I hereby commit to doing our part in achieving these reforms.

In addition to uniformity, we must work together on better coordination among the regulators. I asked both President Nichols and the OCC Chief Counsel Julie Williams last July whether coordination had been achieved among the financial regulators or if more work needs to be done. Clearly, the hoped-for consultations required by the Gramm-Leach-Bliley Act is not being sufficiently conducted. Ms. Williams indicated that more congressional action may be required to govern the flow of information sharing and to protect the confidentiality of those reports.

It is my sincere hope that the agencies will be able to work together to report back to Congress on the best way of achieving this coordination. If not, Congress will return to this issue next year with our own solution. Consumers are not being adequately protected by the current system, and follow-up congressional legislation on this subject may, in fact, be necessary.

For example, in 1992, Martin Frankel was permanently banned by the securities industry for fraudulent activities, and yet he was able to secretly control a small securities firm which he later used as a platform for conducting the biggest insurance scam of the decade.

If the insurance regulators had a coordinated system with the securities regulators to flag fraudulent actors, they would have never let Frankel take control of numerous insurance underwriters. Conversely, if the securities regulators were updated on the continued fraudulent trading activities, both pretend and real, of Mr. Frankel, they could have taken further action to prevent the abuse of the system.

In the year 2000 Americans deserve to have an integrated financial regulatory system where one hand knows what the other is doing. I am proud that we have undertaken and made significant progress on an ambitious reform of our insurance regulatory system. I thank the witnesses who have agreed to join us today to help us understand where we are in this effort, how far we can go, how far we have to go, what alternatives we should be considering and what Congress can do to help better protect consumers and the competitiveness of the industry.

I now turn to the ranking member, the gentleman from New York, Mr. Towns, for an opening statement.

Mr. TOWNS. Thank you, Mr. Chairman, and also thank you for holding this hearing.

We last visited this issue in the context of Gramm-Leach-Bliley, a very important piece of legislation that modernizes our securities banking and insurance laws. Gramm-Leach-Bliley addresses a critical aspect of insurance modernization: the harmonization of State insurance regulations. The harmonization means more competition as State regulatory systems fall out of the way of interstate commerce, raising the standards for customer service and product innovation. Consumers will realize more choices and lower prices as the insurance provisions of Gramm-Leach-Bliley are implemented.

But, as significant as it is, Gramm-Leach-Bliley is only a first step in reforming insurance regulation. Since Gramm-Leach-Bliley was enacted, those in the industry have been diligent in shaping the change. In July, at the first part of this year, we heard testimony about what a uniform system might look like. Today, we will continue that discussion, hearing from more of those who have been and will continue to be instrumental in this process.

I believe something needs to be done to bring uniformity to the insurance industry. Just what that something is, is a question that we need to have answered before moving forward.

Some have suggested a Federal chartering system, very much like the Federal banking chartering system. Others suggest a State-run chartering system or an interstate reciprocal recognition compact.

I said all of that to simply say that it is a difficult issue. I am pleased we are having a second hearing to further look at options for improving efficiency in the insurance industry. I look forward to hearing from our witnesses; and let me again thank you, Mr. Chairman, for calling this hearing and furthering the dialog on insurance modernization. Thank you.

Mr. OXLEY. I thank the gentleman.

The Chair now recognizes the gentleman from Illinois, Mr. Shimkus.

Mr. SHIMKUS. Thank you, Mr. Chairman. I will be brief.

I want to thank you for calling this hearing today. I want to thank the panelists, a wide range of people. I think we will get—hearings are very important for Members of Congress, especially for me, because I like to sit, and I like to listen, I like to learn. And this is really a natural addition to what we did in the financial services bill. This should not surprise anybody that people are now starting to ask these questions since the financial—since insurance was the only financial institution that still would be under regulation by the State.

Illinois prides itself on being a tremendous insurance State; and my good friend, Nat Shapo, continues to do a great job in its regulatory arena. What I like to brag about the State of Illinois is that we don't regulate rates, we let the market dictate rates; and I think the vast majority of Americans would be better served under that type of State purview.

But I look forward to the hearing today. As the ranking member mentioned, we have a lot to really learn and discuss as we proceed cautiously forward.

With that, Mr. Chairman, I thank you for this hearing. I yield back my time.

Mr. OXLEY. Thank you.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. TOM BLILEY, CHAIRMAN, COMMITTEE ON COMMERCE

I would like to thank the Subcommittee Chairman for his important work in putting together this hearing. This Committee has worked in a bipartisan fashion on insurance reform throughout the term, and the Subcommittee Chairman's efforts have helped pave the way for significant reforms.

Last November, this Congress made history by achieving something that no Congress in the previous 66 years had been able to accomplish—agreeing to comprehensive financial services modernization. The Gramm-Leach-Bliley Act was a critical first step towards uniformity in insurance regulation. It established the first ever uniform privacy protections for consumers, and the first ever uniform licensing system for insurance agents and brokers. That statute requires regulators to begin coordinating with each other.

These were important steps to begin modernizing the regulation of insurance. But they are only first steps.

In July, I challenged the insurance commissioners to put their shoulder to the wheel and begin the process of modernizing insurance regulation. I stressed the need for deadlines in implementing plans for speed to market, rate filings, and producer licensing reforms. I also told the commissioners that we expected significant progress between July and today's hearing. We have invited Commissioner Covington to join us today to give us a full briefing on the NAIC's activities. By all reports, the NAIC has made progress.

I fully support the NAIC's efforts. I look forward to finalizing plans on the more simple reforms by this December, with more comprehensive reforms soon to follow. In return, Congress must be ready to move forward with any federal reforms needed to help the States protect consumers.

Last July I also emphasized the need for regulatory coordination. The General Accounting Office is releasing a report on their investigation of Martin Frankel, who committed the single largest insurance scandal last decade. A critical GAO conclusion is something that our Committee has been stressing throughout—the financial regulators need to do a better job of sharing enforcement and examination information. Regulatory coordination may not require Congressional action. But if the regulators can't do it alone, Congress will step in to get the job done right.

I challenge the regulators to work together on a new data base system to share information to prevent fraud. And I challenge our industry witnesses here today to work with the States to implement uniformity and coordination.

Congress should expect to see real reforms put together by the end of this year, with implementation beginning shortly thereafter. And it is my strong hope that the State legislatures will be able to proudly stand behind this effort.

The unfolding of the Martin Frankel scandal demonstrates that much work still needs to be done. As I stated last July, "One way or another, insurance regulation will be reformed." I hope that we can all work together towards fulfilling this effort.

Prepared Statement of Hon. Bobby L. Rush, a Representative in Congress from the State of Illinois

Mr. Chairman, I thank you for taking the time to conduct this hearing on the important subject of Improving Insurance for Consumers, while Increasing Uniformity and Efficiency in Insurance Regulation. I also thank the panel of insurance professionals and administrators who will present their testimony of solutions to the problems surrounding the coverage and protection of consumers.

Insurance protection allows members of the public to interact, facilitate business needs and promote personal growth and prosperity, without the fear of tremendous loss due to mistakes or minimal errors in judgement. The insurance industry is responsible for providing a safeguard to consumers as well as the business community. This should be accomplished without imposing strict regulations that reduce consumer protection, erodes consumer trust, and eliminates the consumers right to privacy and security.

The disturbing GAO report entitled "*Scandal Highlights Need for Strengthened Regulatory Oversight*" highlights a miscarriage of justice which resulted in "more than $200 million in insurance company assets over nearly an 8year period." Scams like these induces consumer distrust in the insurance industry. I am concerned that individual failures by insurance regulators, and legislation which does not do enough to strengthen consumer confidence, will have far reaching negative impacts in this nations commerce.

I am interested to hear what steps will be taken or proposed to reduce the potential for insurance scams.

I look forward to hearing from our witnesses testimony on how this congress can move forward in a collective effort to mitigate problems with consumer protection in the insurance industry.

Prepared Statement of Hon. John D. Dingell, a Representative in Congress from the State of Michigan

Mr. Chairman, I want to thank you for holding this hearing on improving insurance regulation for consumers. Consumers should be our uppermost concern, because in most cases, consumers pay the biggest price when regulators fail to do their job.

We will hear important testimony today about how regulators failed to protect consumers in the insurance fraud case of Martin Frankel. Taxpayers, and policyholders whose losses are not covered by state guarantee funds, will bear much of the burden attributable to Mr. Frankel's embezzlement of insurance assets in excess of $200 million. Today's General Accounting Office's report, which I requested, demonstrates that state insurance regulators were either too blind to see, or too unwilling to acknowledge, the scam Mr. Frankel perpetrated, openly and fearlessly, over a period of eight years. The simple fact is that Mr. Frankel succeeded, not because he was so clever, but because state insurance regulators lacked the skill, authority, access to basic information, resources, and "healthy skepticism" needed to protect consumers.

Perhaps most alarming is the fact that even when Tennessee's insurance regulators finally figured out what Mr. Frankel was doing, they did not warn the public or regulators in other states. Instead, they gave him 60 days to redeposit the assets of Franklin American Life Insurance Company in an account in Tennessee. That's like saying, "I know you have been stealing from me, but I'm giving you 60 days to steal from someone else so you can pay me back."

And that appears to be what happened. During that 60-day period, Mr. Frankel bought another insurance company and entered into a fraudulent reinsurance scheme, producing additional insurance company losses of $5 million in Arkansas and $45 million in Virginia. With these two additional frauds, Mr. Frankel was able to accumulate $50 million of the $57 million Tennessee demanded he put in an account in that state.

Even if state regulators had been more alert, even if they had the resources, authority, access to basic information, and all other things they currently lack, the actions of regulators in Tennessee raise an important question. Does the present system of 50 independent, state insurance regulators encourage each regulator to put too high a priority on taking care of policyholders in his or her own state, instead of exposing a fraud that also affects policyholders in other states? Unless what happened in Tennessee can be explained as an isolated and abnormal occurrence, one could conclude that, under the present system, no one is protecting all insurance consumers against fraud.

Certainly, this case also points out things the states can and should do to strengthen their anti-fraud efforts. For example, had state insurance regulators bothered even to check with their own state securities regulators, the more than $200 million in losses attributable to Mr. Frankel's alleged thievery may have been avoided. And, had employees of the Mississippi State Insurance Department bothered even to talk with each other, the Mississippi department would never have approved redomestication of a Frankel-controlled company with assets of more than $100 million at the very moment Mississippi examiners were close to uncovering Frankel's fraudulent activities.

I understand that, in response to this case, the National Association of Insurance Commissioners (NAIC) has proposed both short- and long-term actions that state insurance departments should take. Some of these recommendations will require action by state legislatures. Others will take development by NAIC committees, as well as legislative implementation by the states, and could take several years to implement.

A far more timely response is needed, especially now that the Gramm-Leach-Bliley Act lets banks, insurance companies, and securities firms engage in each other's businesses. No longer will the fraudulent schemes of rogues like Martin Frankel harm only insurance policyholders. Instead, investors, banks, and the American taxpayer who underwrites bank solvency, may be threatened as well.

Mr. Chairman, if state regulators cannot do the job insurance consumers deserve and require, new regulatory mechanisms must be put in place that will.

I look forward to the testimony of the witnesses.

Mr. OXLEY. The Chair now turns to our first witness, the Honorable J. Lee Covington, Director of the Ohio Department of Insurance Columbus, Ohio. Mr. Covington, welcome back and look forward to your report.

STATEMENT OF HON. J. LEE COVINGTON, DIRECTOR, OHIO DEPARTMENT OF INSURANCE

Mr. COVINGTON. Thank you, Chairman Oxley, members of the subcommittee. My name is Lee Covington. I am Director of Insurance in the State of Ohio and in that capacity I serve as Chair of the National Association of Insurance Commissioner's Regulatory Reengineering Task Force and the Electronic Commerce and Regulation Working Group.

Thank you for inviting me here to testify regarding the efforts of Ohio and other State insurance regulators to implement Gramm-Leach-Bliley and to modernize State insurance regulations. Mr. Chairman, I am especially pleased to be here because our home State of Ohio is a leading State in modernizing our regulatory system to fully meet the needs and expectations of insurance consumers and the financial services industry.

Ohio was the first State to adopt reciprocity for agent licensing. We implemented just a last year a state-of-the-art Internet agent licensing system, and we are piloting the National Insurance Producer Registry. I recently adopted regulations and will be seeking legislation to speed the time for insurance product approvals. I also chair the NAIC committee with the goal of facilitating the use of e-commerce.

Mr. Chairman and members of the committee, I join my colleagues in thanking you for your long-standing support of functional regulation of insurance by the States and for your interest in and support of our efforts to make real progress in our regulatory modernization initiatives. Your commitment and work in this area is having a real impact in Ohio and through our combined efforts will benefit Ohio's consumers and insurers.

A full update of our work to implement GLBA since your July hearing is provided in my written testimony.

With respect to privacy, the NAIC's Privacy Working Group completed work on a privacy model just last week, and our full membership will vote next week on that model. This model tracks GLBA closely and will give insurers clear, uniform guidelines to follow. Ohio already has in place privacy laws that meet the requirements of GLBA and exceed the requirements of GLBA.

With respect to multi-State agent licensing under GLBA, earlier this month we took another important step toward our goal of one-stop agent licensing by launching a pilot of the National Insurance Producer Registry in four States, as I mentioned before, including Ohio; and we expect all States to be operational in 2001. Through NIPR, nonresident agents will receive a license on a reciprocal basis within 24 hours of submitting an electronic application.

Mr. Chairman, moving now to our modernization initiatives, during the subcommittee's July hearing and, as you mentioned this morning, you recognized that insurance commissioners through our statement of intent have demonstrated now that we can talk the talk. Through our licensing initiatives and wide action in other areas, Mr. Chairman, we want to show you that we can indeed walk the walk when it comes to implementing meaningful reforms.

I am excited to report that State regulators remain strongly committed to our modernization initiatives with unprecedented consensus and we have accomplished just what you had hoped to see, specific proposals with specific timeframes. I applaud the outstanding leadership of NAIC President George Nichols, who is here with me today, and the intense work of each State insurance commissioner since this law's enactment. We have moved forward on our bold set of reforms.

I want to give you an update on the progress of two of our most important initiatives that go far beyond the requirements of GLBA.

First, the Speed to Market Working Group. Regulators agree that, under the current system, it takes far too long to introduce new insurance products. This is not good for consumers, and it is not good for the insurance industry. The working group recently announced that it would appoint two subgroups to focus its efforts.

First, the Coordinated Advertising, Rate, and Form Review Authority subgroup will develop the details for a single-point product filing process through a centralized organization and uniform standards where appropriate. A limited launch of CARFRA, as we call it, in 10 States is now scheduled for the first quarter of 2001.

A second subgroup, which I chair, will evaluate various recommendations for improving other State-based systems, including a list of recommendations that includes electronic filings, commercial lines deregulation where appropriate, and movement toward a more market-oriented regulatory system where appropriate. This subgroup was charged with developing recommendations by December 2000.

The second initiative that is one of our most important is the National Treatment of Companies Working Group. It is charged with establishing regulatory procedures that will treat eligible insurance companies the same across the Nation, and it has set forth time lines for achieving this goal, including, first, adoption of a uniform company application by all States before the end of this year; second, development of "best practices" for regulatory reviews by June, 2001; and, finally, full implementation of the complete national treatment process from June, 2001, through June, 2002.

We look forward to the continued positive impact that these initiatives will have on our work to protect consumers through an efficient and effective regulatory system; and we look forward to working with the Congress, our Governors, legislatures, and all other interested parties as we continue to develop and implement the GLBA required regulations and legislation and our State regulatory modernization initiatives.

Thank you, Mr. Chairman, members of the committee.

[The prepared statement of Lee Covington follows:]

PREPARED STATEMENT OF LEE COVINGTON, DIRECTOR OF INSURANCE, STATE OF OHIO

INTRODUCTION

Chairman Oxley and members of the Subcommittee, my name is Lee Covington. I am the Director of Insurance in state of Ohio and serve as Chair of the National Association of Insurance Commissioners' (NAIC) Regulatory Re-engineering Task Force, the Electronic Commerce & Regulation Working Group, and the Improvements in State-Based Systems Subgroup of the Speed to Market Working Group.

Thank you for inviting me to testify regarding the efforts of Ohio and other State insurance regulators, in our own States and through our work as members of the NAIC, to implement the Gramm-Leach-Bliley Act (GLBA) and modernize State insurance regulation. I am especially pleased to be here because Ohio is a leading State in modernizing our regulatory system to fully meet the expectations of insurance consumers and the financial services industry.

Mr. Chairman and members of the Committee, I thank you for your leadership in working to enact GLBA in the face of changing consumer demands and a financial services industry marked by globalization, convergence, consolidation, and technological innovation. I join my colleagues in thanking you and this committee for your support of functional regulation of insurance by the States when enacting GLBA, for your continued support of State insurance regulation, and for your support of our efforts to make real progress in our regulatory modernization initiatives.

During the Subcommittee's hearing on July 20, 2000, Chairman Oxley noted that insurance commissioners, through their "Statement of Intent", "have demonstrated now that they can "talk the talk"; if they can also "walk the walk", then insurance consumers and producers can fully benefit from uniformity without the need for a new federal system." Chairman Oxley also requested an update "to assess what progress has been made and whether there is a sufficient continuing commitment to uniformity." Further, Chairman Oxley "hope[d] that the NAIC working groups [would] not only be able to come up with specific proposals for achieving their goals, but to attach specific time frames to implement those proposals in the 50 States." I am excited to report that State insurance regulators remain strongly committed to our modernization initiatives with unprecedented consensus, and after a series of meetings leading to our most recent National Meeting, we have accomplished just what you had hoped to see—specific proposals with specific time frames. I applaud the outstanding leadership of NAIC President George Nichols over the past 10 months and the intense work and commitment of each State insurance commissioner as we have moved forward on each of our initiatives.

Today, I would like to make three points about where State regulators stand in implementing GLBA and achieving our modernization goals—

- First, the NAIC and State insurance regulators are on track to implement all provisions of GLBA, and move beyond its requirements with our own plan to achieve national uniformity and efficiency for agent licensing.
- Second, consistent with the "Statement of Intent—The Future of Insurance Regulation" signed by all state Insurance Commissioners in March of this year, the NAIC and State regulators are working with the insurance industry and consumers on several fronts to develop specific programs with specific time frames for implementation that will substantially improve the insurance supervision process while creating regulatory efficiencies and reducing costs for insurance companies and agents.
- Third, I am proud to report that our experience in Ohio provides a good example of the substantial progress being made toward modernizing State insurance regulation.

STATE REGULATORS ARE ON TRACK IMPLEMENTING GLBA

At the Subcommittee's hearing on July 20, 2000, NAIC President George Nichols gave a detailed summary of the steps being taken by NAIC and State regulators to implement GLBA. He concluded: "The NAIC and State insurance regulators are well on the way to implementing the provisions of GLBA as intended by Congress." His statement remains true. The NAIC completed several additional steps of our GLBA implementation at meetings held in Kansas City and Dallas after President Nichols testified.

My testimony today provides an update concerning State regulatory efforts to implement the three basic GLBA mandates identified by President Nichols—

a) Coordinating and cooperating with Federal functional regulatory agencies that supervise banks and securities firms;

b) Issuing privacy rules to protect the non-public financial information given by consumers to insurance providers; and

c) Establishing a national licensing system for insurance agents and brokers in order to avoid the creation of the National Association of Registered Agents and Brokers (NARAB).

I will also update you on two additional areas—national treatment of insurers and speeding insurance products to market—where State regulators are moving beyond the requirements of GLBA to modernize our regulatory system.

COOPERATING WITH FEDERAL REGULATORS UNDER GLBA

The NAIC continues to believe that establishing sound working relationships with Federal regulators is absolutely essential for State insurance departments under GLBA. Long-standing efforts to work closely with our Federal counterparts are now consolidated under the NAIC's Coordinating with Federal Regulators Working Group, which has been given broad responsibility to stimulate cooperation at all levels.

The NAIC's first priority for establishing regulatory cooperation is to negotiate and sign written agreements between Federal and State agencies laying out the ground rules for sharing information and keeping it confidential when necessary. When signed by individual State insurance departments and Federal agencies, these comprehensive agreements will permit information to be shared regarding financial condition, market conduct, and regulatory enforcement matters. At present, NAIC is negotiating model regulatory cooperation agreements with Federal banking agencies as follows—

Federal Reserve Board—After four months of joint effort, NAIC has recently received the latest version of a draft agreement from the Federal Reserve staff. This agreement was distributed last week to members of the Coordinating with Federal Regulators Working Group for review and comment. We expect to reach final agreement on a model by the end of the year.

Office of Thrift Supervision—NAIC approved a comprehensive model regulatory agreement with OTS in June of this year. So far, the agreement has been signed by 23 States. This number will rise as more States direct their attention to completing Federal cooperation agreements.

Comptroller of the Currency—The OCC says it will soon deliver to NAIC a comprehensive draft agreement based upon the OTS model. When NAIC receives it, we will distribute it to Working Group members for review and comment. Currently, 28 States have signed a more narrow consumer complaint sharing agreement with OCC that was approved by NAIC in 1999.

Federal Deposit Insurance Corporation—FDIC is working on a draft agreement, and will be sending it to NAIC in the near future.

The second priority for effective cooperation is to establish personal contacts at Federal agencies that will foster open communication, mutual understanding, and practical cooperation on monitoring and enforcement matters. The process of establishing such personal contacts between State and Federal regulators is going very well. While we have good initial working relationships with all the banking regulators, our contacts with the Federal Reserve and OCC are the most advanced due to the immediate demands of handling the Citigroup merger and increased insurance activities by national banks.

Relations with the OCC are a good example of how we are proceeding. During the past year, the Coordinating with Federal Regulators Working Group conducted a series of day-long meetings with senior OCC supervision officials and State insurance experts to exchange views and explore general supervision methods. Now, relations are moving forward to resolving the important details of developing examination procedures that address proper supervision of insurance activities by national banks. Through these efforts and continue cooperation and communication, we expect to develop an efficient and effective framework for implementing functional regulation as required by GLBA. We hope to avoid Federal preemption of State insurance laws wherever possible. NAIC expects this natural evolution from general policy discussions to coordinating supervision details will serve as the model for establishing sound working relationships with each of the Federal banking agencies during the coming year.

MEETING GLBA CONSUMER PRIVACY REQUIREMENTS

Members of the NAIC have been discussing and addressing the privacy of personal information, including health information, for more than 20 years. In 1980, the NAIC adopted the Insurance Information and Privacy Protection Model Act, which generally requires insurers to receive authorization from individuals ("opt-in") to disclose personal information. In September 1998, NAIC adopted the Health Information Privacy Model Act because of the special issues surrounding health information. This model treats personal health information as a different type of information that receives a higher level of privacy protection. NAIC records indicate that 17 States have adopted all or part of the 1980 model, while the 1998 health model has not yet been adopted by any State. The NAIC believes State privacy regulations based upon the 1980 and 1998 NAIC models will exceed GLBA requirements, which means they will remain in force under Section 507 of that law.

To meet the recent challenge of specific GLBA privacy requirements, the NAIC's Privacy Issues Working Group moved swiftly to construct model insurance consumer privacy regulations that will serve as guidance for States that do not presently have regulations satisfying the Title V privacy provisions in GLBA. The purpose of these regulations is to help State insurance authorities comply with the minimum requirements of GLBA quickly while State Insurance Commissioners consider whether additional privacy protections are needed across-the-board for all consumers of financial services, including insurance.

After six months of public comment and hearings on four separate drafts, the Working Group approved a final model privacy regulation last week at the NAIC's Dallas National Meeting. Upon approval by the full NAIC membership, which is expected during the next month, this model will move to the States for consideration. States adopting this model will be assured that they meet the minimum requirements of GLBA.

In drafting the model regulation, the Working Group sought to strike a good overall balance between achieving uniformity with Federal privacy rules and adequately protecting personal information more commonly associated with insurance products. The NAIC model also tracks the November 13, 2000, effective date and July 1, 2001, compliance deadline set forth in the Federal regulations.

Some departures from the Federal rules were necessary to reflect the special nature of the insurance business and its impact on consumers—

1. In the NAIC model regulation, "consumers" include not only individuals who have a direct relationship with an insurer, but also other individuals such as claimants, beneficiaries, and persons entitled to coverage under group plans, employee benefit plans, and workers' compensation plans.
2. Because insurance providers typically collect much greater amounts of health information than banks, the NAIC model includes provisions that protect personal health information. The health provisions of the model regulation give health information a higher level of privacy protection than financial information receives under GLBA. In general, insurers are prohibited from sharing protected health information with any other party—affiliate or non-affiliate—without the express consent of the consumer to which the information applies (opt in). The 1980 NAIC Model adopted by 17 states contains this same general rule, and therefore, insurers in those states are already complying with these provisions. Finally, to promote uniformity and implementation of privacy protections, the health provisions of the draft model regulation will not apply to insurers who are in compliance with the health information privacy regulations promulgated by the Department of Health and Human Services (HHS) pursuant to the Health Insurance Portability and Accountability Act (HIPAA).

SATISFYING THE NARAB PROVISIONS IN GLBA

Following passage of GLBA, the NAIC moved quickly to amend its Producer Licensing Model Act to comply fully with the NARAB provisions in GLBA, and earlier this month, the NAIC launched a pilot of the National Insurance Producer Registry (NIPR). The model act is the vehicle for States to satisfy the GLBA statutory requirements because it fully implements the requirements for licensing reciprocity and uniformity among States. Adoption of the model by a majority of States by November 2002 will assure that NARAB will not be created. Although our immediate goal is minimum compliance with GLBA, our ultimate goal is for all 50 States to be operating under a national system of unified standards and procedures.

The NAIC is taking several additional steps to improve agent licensing. In partnership with the National Insurance Producer Registry (NIPR), a non-profit affiliate of the NAIC, we have been aggressively investing over the past three years in modernizing our technical infrastructure to develop a more centralized producer licensing processing center. As stated previously, earlier this month, NIPR began a pilot project with four states participating, including Ohio, and we expect to have all states operational in 2001. Through NIPR, non-resident agents will be eligible to receive a license on a reciprocal basis within 24 hours of submitting an electronic application.

At present, the NAIC maintains a regulatory network and centralized database of 2.6 million of the Nation's 3 million producers. This information is available to regulators and insurance companies over the Internet, and is updated daily by automated processes at the State insurance departments.

Currently, 32 States are online with the Producer Database and the target is to have all 50 States contributing to PDB between December 2000 and June 2001. Because PDB is a mirror of the State licensing database, NIPR is creating a single system to automatically process appointments, terminations, and uniform non-resident license applications on behalf of individual State insurance departments against data in PDB within 24 hours of receiving the electronic data from an insurance company or producer. Approximately 110,000 producer appointments and terminations are being processed by 24 States through NIPR monthly right now, and we expect to have the entire system operational and all 50 States participating in 2001.

The next key step in this process will be the implementation of a single electronic licensing application. These system improvements will bring about regulatory efficiencies that far exceed the expectations in NARAB and set the stage for national uniformity.

GOING BEYOND GLBA AND MODERNIZING REGULATION—NATIONAL TREATMENT OF INSURERS

One key area where State regulators are moving beyond the requirements of GLBA is national treatment of insurers doing business in multiple jurisdictions. This year, the NAIC established the National Treatment of Companies Working Group, and gave it responsibility for identifying regulatory procedures that will treat eligible insurance companies the same across the Nation. One such procedure involves the licensing process for an insurer to obtain a certificate of authority to conduct business in a State. Already, 29 states are participating in the NAIC's Uniform Certificate of Authority Application (UCAA), and one more is in transition. The Working Group's goal is to have all 50 states and the District of Columbia using the UCAA by December 2000.

Another goal is standardizing the licensing review process. While the UCAA provides a uniform application, the Working Group is looking to expand this effort to also include standardized review criteria nationwide. NAIC plans to develop a streamlined operating structure that would give certain companies "national treatment" for regulatory procedures related to company licensing, solvency monitoring, holding company supervision, approval of mergers and acquisitions, market conduct reviews, and corporate re-organizations.

At NAIC's National Meeting in Dallas last week, the National Treatment of Companies Working Group discussed these regulatory efficiency goals, and set forth a timeline for achieving them in four progressive steps—

1. Obtain commitments from all NAIC members to participate in the ALERT program, using the UCAA, by December 2000, and to achieve active participation by all NAIC members by June 2001. ALERT stands for "Accelerated License Evaluation Review Techniques", a program that streamlines regulation by promoting the single license application process, including the application form and review timelines, which is accepted in all participating States.
2. Develop "best practices" for reviewing significant holding company transactions and company licensing applications by December 2000 and June 2001, respectively, and encourage all States and the District of Columbia to administer such reviews on a consistent and uniform basis.
3. Implement the national treatment process through a memorandum agreement between June 2001 and June 2002, and continue to examine whether additional legislative action is need to fully implement the national treatment initiative.
4. Develop enabling State legislation, if necessary, to provide state insurance regulators with the legal authority to implement a national treatment system by June 2003.

The Working Group also discussed possible legal options for implementing national treatment. Using a model law, memorandum agreement, interstate compact, and Federal involvement were all considered. The use of a memorandum of understanding was considered to be an appropriate vehicle for accomplishing the initial implementation of the national treatment process in Goal 3. For the long-term, an interstate compact was considered as a possible vehicle for implementing national treatment if necessary from a legal and implementation standpoint.

SPEEDING UP THE PRODUCT APPROVAL PROCESS

The Speed to Market Working Group is responsible for identifying one-stop filing procedures and a more efficient process for State regulatory approval of insurance products marketed to consumers. State regulators recognize that under the current 50-state system, it takes far too long to introduce a new insurance product. This is not good for consumers or the insurance industry. In Dallas, this Working Group appointed two subgroups to focus its efforts on speeding up the product approval process.

The Coordinated Advertising, Rate, and Form Review Authority (CARFRA) Subgroup will develop the details for single-point product filing. CARFRA is a proposal that will assist insurance regulators in reviewing and approving rate, form, and advertising filings by creating a new centralized organization specifically tasked with that goal for participating States. It will provide insurers with a single point of contact and uniform standards for eligible products. For consumers, it will speed beneficial insurance products to market while preserving high quality regulatory review and effective consumer safeguards. At the Dallas national meeting, the Speed to Market Working Group announced that a limited launch of CARFRA will occur within the first quarter of 2001, and assigned the subgroup the responsibility for developing the operational procedures necessary to implement CARFRA.

A second subgroup, the Improvements in State-Based Systems Subgroup, which I chair, will evaluate various suggestions for improving State-based systems. It will review a list of suggestions that include, but are not limited to:

- Implementation of the System for Electronic Rate and Form Filings (SERFF) in all states. SERFF uses a point-to-point electronic communication tool where filings are sent from insurers over the Internet and routed to a State from a central server;
- Agreement on a uniform approach to filing exemptions for products sold to large commercial policyholders;
- Staffing and training of rate, form, and advertising review units to ensure quality reviews and prompt turnaround time for filings;
- Elimination of any requirements that are not published in statutes, regulations, bulletins or guidelines;
- Evaluation of prior approval requirements and movement toward market-based regulation;
- Improvements to the Market Conduct Examination process; and
- Improvements in consumer education.

The Speed to Market Working Group tasked the Improvements in State-Based Systems Subgroup with the responsibility for developing specific proposals by the December 2000 NAIC national meeting. The Working Group also heard comments from interested parties during its meeting in Dallas. Representatives from consumer interests and various sectors of the insurance industry provided input and guidance to shape the CARFRA proposal and encourage improvements to State regulatory processes. The Subgroups have planned a series of meetings during September and October, and the entire working group plans to hold another meeting in November 2000.

FACILITATING THE USE OF E-COMMERCE

The NAIC E-Commerce and Regulation Working Group, which I chair, developed a resolution adopted by the NAIC earlier this year endorsing the Uniform Electronic Transactions Act and issued a self-assessment guide for use by the states to identify ten (10) potential barriers to the use of e-commerce. Within the next few weeks, the Working Group expects to adopt a Model Bulletin for use by the States to implement many of the recommendations set forth in the self-assessment guide. The NAIC has been progressive in its work to facilitate the use of e-commerce, recognizing that both consumers and insurers want the cost savings and convenience of using the internet to purchase insurance.

OHIO IS A LEADER IN MODERNIZING STATE INSURANCE REGULATION

I am proud to report that the State of Ohio has become a leader in implementing the policies necessary to implement GLBA and modernize state insurance regulation. In Ohio, we are committed to fostering a competitive marketplace for the benefit of consumers and the insurance industry, and focusing our regulatory resources in priority areas that add the most value to our work of protecting Ohio consumers. Through our independent efforts and by implementing the NAIC initiatives, we are seeing real progress as we continually work to carry out these objectives.

With respect to GLBA implementation, Ohio currently has in place privacy laws that exceed the requirements of GLBA, and we plan to introduce legislation in the near future to make minor procedural changes to the law to fully comply with GLBA. We have also established good working relationships with each of our Federal agency counterparts through personal meetings involving regional heads of the respective Federal agencies. In addition, Ohio participates on the NAIC team that regularly meets with representatives of the Federal Reserve Board in Washington D.C.

Most notably, in the area of agent licensing, Ohio has led the country. Ohio was the first State that enacted reciprocal licensing for non-resident agents, and therefore, was the first State to comply with GLBA's NARAB provisions. In addition, last year, Ohio implemented a state-of-the-art internet agent licensing system that is regarded as one of the best in the country, if not the best. Using this system, an agent can submit an application on-line, pay the application fee on-line, complete the fingerprinting and background check using an electronic system, schedule a test on-line, take the test using a state-of-the art system, receive the exam results immediately after the test, walk out with a license if successful, and obtain a company appointment on the same day using our internet appointment process, all of which takes less than 7 days. Because of this work, Ohio was selected to be one of the four pilot states for the National Insurance Producer Registry, which was launched earlier this month. As stated previously, NIPR will allow one-stop licensing for non-resident agents in all 50 States.

With regard to insurance regulatory modernization initiatives, Ohio is also a leader. Just yesterday, I signed two regulatory bulletins that will allow 81% of all property and casualty insurance products to be submitted on "file and use" basis. I plan to seek legislation that will move our product filing system to a file and use system for all appropriate products and exempt certain products and rates from the filing requirement altogether where appropriate. For example, just yesterday, I signed a bulletin that exempted from the filing requirements all Special Filings and Excess Rate Consent Filings. To support these initiatives, Ohio was among the first—and was the fastest—to introduce the NAIC-sponsored System for Electronic Rate and Form Filing (SERFF). SERFF will be a vital tool for implementation of CARFRA and improving the filing and approval process for products not selected for the CARFRA process. Ohio has already received 165 property and casualty filings since March 2000, and we believe the new web-based version of SERFF, scheduled for release in October 2000, will open the door to widespread use among the industry and all of the States.

As noted earlier in my testimony, as Director of Ohio Department of Insurance, I chair the NAIC's E-Commerce and Regulation Working Group, the goal of which is to facilitate the use of e-commerce, and the Improvements to State-Based Systems Working Group, the goal of which is to improve the State-based insurance product approval process.

We look forward to the continued positive impact these initiatives will have on our work to protect consumers through an efficient and effective regulatory system.

CONGRESS CAN HELP IMPROVE STATE REGULATION

Improvements in several Federal laws affecting State insurance regulation would help give us all the tools we need to meet the challenges of the modern marketplace. During Congressional consideration of GLBA, the NAIC suggested several amendments to Federal laws that would be useful.

The primary benefit of making the following changes to Federal laws is to achieve uniform regulatory procedures and national enforcement quickly by using the existing system of State regulation. The NAIC proposes that Congress—

- Provide State insurance regulators with access to the national criminal information database (NCIC) through the NAIC or its affiliates for regulatory purposes and for checking criminal histories as required by the Federal Insurance Fraud Prevention Act. (18 USC 1033)
- Grant Federal immunity from liability for NAIC and NIPR database activities related to creating a national licensing and enforcement system.
- Protect the confidentiality of regulatory communications among NAIC, State regulators, and Federal agencies.

NAIC and its members will be pleased to provide additional information and assist Congress in adopting Federal legislation to achieve these goals.

CONCLUSION—STATE REGULATORS ARE MEETING THE GLBA AND MODERNIZATION CHALLENGE

Working together through the NAIC, Ohio and other State insurance regulators are well on the way to implementing the provisions of GLBA as intended by Congress. More importantly, we have shown real progress in our efforts to do far more than Congress or industry representatives have asked us to do regarding uniformity, efficiency, and modernization. We look forward to working with Congress, our Governors and legislatures, and all other interested parties as we continue to develop and implement the GLBA required regulations and legislation, and our State insurance regulation modernization initiatives.

Mr. OXLEY. Thank you, Mr. Covington.

The Chair would recognize himself first for a couple of questions.

Let me indicate, first of all, we appreciate the work that you and the group have done. There is a lot on your plate. What obstacles do you see to achieving uniformity and what can Congress do to help you achieve those goals?

Mr. COVINGTON. Mr. Chairman, certainly there are always obstacles in the implementation process. But we feel very confident that we have put ourselves the best position to win and so we are very optimistic that we can overcome any obstacles during the implementation process. I think it will take a concerted effort by all interested parties to come together and agree on an approach and for moving forward.

Certainly we have different competing interests between insurers, banking, agents and consumer groups. There will have to be, as in any public policy, some compromise and some consensus as we move forward.

With respect to how Congress can—well, let me mention also that the State legislative process certainly could be an obstacle. But we are optimistic that we can implement many of these initiatives without—on our own initiative. We will work very hard to move forward on those initiatives that we can get in place very quickly; and if we need to move forward through the State legislation process, we will certainly do so.

There are a number of——

Mr. OXLEY. Let me interrupt, what specifically would the potential problem be with the State legislatures? You mean in terms of implementing the reforms or something that would go in the opposite direction?

Mr. COVINGTON. Mr. Chairman, I think a potential obstacle could just be time. So the NAIC members have certainly focused on initiatives that we can implement on our own, on our own without State legislative approval; and we find that we can do that in many areas.

One of the things that I will note is the National Council of Insurance Legislatures has been very supportive of our efforts. We have worked very closely with them. Again, we feel very optimistic that they are on board with these initiatives and the need to modernize our insurance regulatory system. So we are very optimistic about that process. But we want to move forward with the reforms we can make.

And then, if necessary, let me highlight that if necessary and if legally necessary, in some areas, we can work with our State legislatures to solidify the framework that we establish.

Mr. OXLEY. So in response, but our—I asked you specifically what we could do. The bottom line, as I take it, is we need to keep watching what you do. But in terms of moving—in terms of legislation, that would not be helpful at this point, is that fair?

Mr. COVINGTON. We don't see at this point that legislation is necessary. We do encourage the committee and thank the committee for its oversight role, for its monitoring and for holding us accountable toward—as we move forward in the regulatory processes.

One thing that Congress may be able to help us do is to provide access to the National Crime Information Center, the information that is provided through that Center. That will certainly help our efforts. We may need help in the area of confidentiality, as you mentioned earlier. In addition to that, currently States have indemnity under State indemnity laws and sovereign immunity; and it may be necessary that the NAIC also be granted that type of immunity as we work concertedly through that association.

Those are some specific things that may arise in the future, and we will certainly come back and work with this committee and the Congress if we need those.

Mr. OXLEY. Thank you.

Let me now recognize the ranking member, the gentleman from New York.

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

Frankel operated in five different States, and the scams he perpetrated went on for 8 years. Doesn't it clearly indicate that the failure to detect this fraud is not unique to the State of Tennessee but instead a common problem for all of the five States?

Mr. COVINGTON. Well, Congressman Towns, certainly we have recognized that there are deficiencies in the system. I must admit that, as you know, I came today to testify on our modernization initiatives and am not fully prepared to address that issue. We did not have the issue in Ohio. I am not a member of the ad hoc task force that the NAIC put together. We would certainly be happy in the future to provide the appropriate person from the NAIC, including President Nichols, to provide a full briefing of our activities to address the issues that arose in the Frankel matter.

Mr. TOWNS. Well, can we—I will move on to another subject. I respect that.

In your statement you asked Congress to provide State insurance regulators with access, access to the National Criminal Information Data Base maintained by the Justice Department. However, the GAO report says Justice officials claim that the only reason most State insurance regulators do not currently have access to the criminal history data is because they lack law enforcement authority. How many State insurance regulators have authority to enforce criminal laws which Justice says they need to get access to the Federal criminal history data base?

Mr. COVINGTON. Congressman Towns, I do not have the specific numbers, but that is correct that many of our States do not have law enforcement authority under the current laws. That is—I have reviewed the ad hoc report in preliminary detail in a preliminary fashion. I do know that is one of the recommendations that the ad hoc task force has placed on the table, that States pursue law enforcement authority under that statute so they can access that data.

Mr. TOWNS. Many of the recommendations require further development by the NAIC committees and implementation by State legislatures and, therefore, could take a long, long time to implement. Do you have any idea when you feel this could be implemented?

Mr. COVINGTON. Congressman Towns, I do not have a precise estimate on the time that it would take to implement all these initiatives. I do know that we are working very hard to implement the initiatives that we can, and there are many that we can do on our own. We agree that the process today is too slow. We are working hard. I think, as we have demonstrated over the last 6 to 9 months, we can act quickly; and we look forward to addressing those issues in the very near term.

Mr. TOWNS. Suppose we get into timetables, and if a State fails to implement the recommendations by some point in the future would the State lose its NAIC accreditation?

Mr. COVINGTON. Congressman Towns, again, I am probably not the best person to testify on that matter. There is a detailed ad hoc report. There is probably—I know what there is another person that can address those issues more precisely. I do know that a number of those matters are under consideration.

Mr. TOWNS. On that note, I yield back, Mr. Chairman. Thank you very much.

Mr. OXLEY. The Chair now recognizes the gentleman from Iowa, Mr. Ganske.

Mr. GANSKE. Thank you, Mr. Chairman. I would note that Mr. Covington is from Ohio and the lead paragraph in our staff memo quotes from the Insurance Commissioner of Iowa. It must be just a coincidence.

I think this is an interesting hearing. I have another hearing, so I will have to leave after I hear the next panel's testimony.

I am interested in getting educated on the pros and cons of some of the proposed solutions for improving the efficiencies and sharing of insurance. I would, as a caveat, point out that 25 years ago Congress passed a law called the Employee Retirement Income Security Act that preempted State insurance regulation in health care and that we have been dealing with the consequences the last 4 or 5 years here in Congress with, in my opinion, insufficient oversight of HMO abuses. So when we look at such things as a Federal charter I think we will need to learn some lessons from the past on that.

As I look over the request that NAIC is making to Congress, for instance, utilizing Social Security numbers for licensing purposes, granting exemptions there the Fair Credit Reporting Act, providing State insurance regulators with access to national criminal data bases, granting Federal immunity from liability for data base activities and protecting the confidentiality of regulatory communications, all of these areas involve privacy issues. And it is the privacy issue which I think will be the major issue involving insurance and banking, securities, financial services, for the next several years. That is a Gordian knot to solve the problem so that we protect consumers and yet at the same time provide for ability to do research, to utilize those data bases in ways that would be useful to protect consumers as well as to potentially affect consumers' privacy. So it is useful, I think, to have this hearing, but I think at the basic level it is part of a larger problem that Congress is going to be dealing with.

I must admit that I have a—I think the McCarren and Ferguson Act has been a good act. As a Republican, I have spoken on the floor many times on the benefit of State control and local control, whether it is for education or for insurance or other things. I think it is correct in that the closer you can get to the constituent, the citizen, the person affected with your government, the more common sense you tend to see, rather than regulations coming out of Washington.

Finally, I would just add as a warning, for those who are thinking that it might be good to have a Federal charter, just sometimes be careful for what you wish for. Because you very well may end up not with one layer but with two. The political process can get very, very messy. And for those in the business community who don't want to see additional regulations, I would be very, very careful on this issue.

With that, Mr. Chairman, I will yield back.

Mr. OXLEY. The gentleman yields back.

The Chair is now pleased to recognize the gentleman from Illinois, Mr. Shimkus.

Mr. SHIMKUS. I just have one question for Mr. Covington.

In putting together a uniform licensing system, what steps can the regulators take to ensure that their data bases will be coordinated with the securities and banking regulator data bases to integrate oversight and prevent fraud?

Mr. COVINGTON. Congressman, we are certainly committed to cooperative effort with the Federal agencies, and we have ongoing dialog currently with all of our partner Federal agencies to achieve just what you have cited, to try to have coordination between the information and sharing of that information. And it is even more important in this day of convergence through Gramm-Leach-Bliley, and we are very committed to achieving that objective.

Mr. SHIMKUS. Can you explain the Coordinated Advertising, Rate, and Form Review Authority?

Mr. COVINGTON. Congressman, the coordinated advertising rate and review authority is a mechanism through which we can have a one-stop, single-filing process through a centralized facility with uniform standards for application. That is the basis of what the CARFRA, as we call it, proposal entails.

We have appointed just last week a work group to ferret out all of the details of that proposal, and will be conducting a limited launch of that authority in the first quarter of 2001. It may sound like a simple idea, and it is meant to be simple, but that is the basics of what CARFRA provides for.

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

Mr. OXLEY. The gentleman yields back.

Mr. Covington, thank you so much for your appearance today. And best of luck in your endeavors. We will be watching very closely and keeping close contact with you and all the NAIC folks regarding this very important issue.

Thank you very much.

Mr. COVINGTON. Thank you, Chairman Oxley, and thank you for your leadership.

Mr. OXLEY. The Chair would call up our next panel: John G. Turner, Vice Chairman of ING Americas from Minneapolis, Minnesota, on behalf of the Financial Services Roundtable; Mr. Drayton Nabers, Jr., Chairman and Chief Executive Officer, Protective Life Corporation, Washington DC, on behalf of the American Council of Life Insurers; Philip H. Urban, President and Chief Executive Officer, Grange Insurance Companies, Columbus, Ohio, on behalf of the National Association of Mutual Insurance Companies; Robert V. Mendelsohn, Chief Executive Officer, Royal & SunAlliance, Charlotte, North Carolina; Glen J. Milesko, President and Chief Executive Officer Banc One Insurance Services Corporation, Milwaukee, Wisconsin, on behalf of the American Bankers Association Insurance Association; Mr. Ronald A. Smith, President, Smith, Sawyer & Smith Inc., Rochester Indiana, on behalf of the Independent Insurance Agents of America; and Richard J. Hillman, Associate Director, Financial Institutions and Markets Issues, GAO, here in Washington.

Gentlemen, thank you all for your appearance. And we will begin with Mr. Turner. And if we can, if we have enough microphones to go around, Mr. Turner, I would ask of you and the panel to keep your statements to 5 minutes so that the panel has plenty of time to answer questions and develop the issue.

All of the prepared statements will be made part of the record and so ordered.

Mr. Turner.

STATEMENTS OF JOHN G. TURNER, VICE CHAIRMAN, ING AMERICAS, ON BEHALF OF THE FINANCIAL SERVICES ROUNDTABLE; DRAYTON NABERS, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PROTECTIVE LIFE CORPORATION, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS; PHILIP H. URBAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GRANGE INSURANCE COMPANIES, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES; ROBERT V. MENDELSOHN, CHIEF EXECUTIVE OFFICER, ROYAL & SunALLIANCE ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION; GLEN J. MILESKO, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BANC ONE INSURANCE SERVICES CORPORATION, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION INSURANCE ASSOCIATION; RONALD A. SMITH, PRESIDENT, SMITH, SAWYER & SMITH, INC., ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA; AND RICHARD J. HILLMAN, ASSOCIATE DIRECTOR, FINANCIAL INSTITUTIONS AND MARKETS ISSUES, GENERAL ACCOUNTING OFFICE

Mr. TURNER. Chairman Oxley, Ranking Member Towns, and Representative Ganske, I am John G. Turner, Vice Chairman, ING Americas, and former Chairman and CEO of ReliaStar Financial Corporation.

ING Americas is part of the Amsterdam-based ING Group. We are one of the largest integrated financial services organizations in the world, and after acquisition of Aetna Financial Services is completed this year, we will have over $100 billion of assets in the U.S. Worldwide, ING has over 500 $billion in assets under management.

This year marks my 40th year in the life insurance business. I can tell you from personal observation over time, the forces for change in the regulatory arena have never been more compelling.

The Financial Services Roundtable national association, whose membership is reserved for the 100 largest diversified financial services firms, including banks, insurance companies, and securities firms, very much welcomes this opportunity to testify before you on a very major piece of unfinished business in the modernization of the American financial system, the creation of an optional Federal insurance charter that will parallel the national banking charter.

Let me emphasize at the outset that the Roundtable strongly favors effective and efficient regulation, regulation that is market based and serves consumer needs in a competitive and innovative way.

Mr. Chairman, there has never been a broader consensus on the need for major structural improvement in the regulation of insurance. Simply improving the State insurance system given us by the past may not be sufficient for those insurers that compete directly with other financial services firms on a national level. State reform can come, but with 51 regulators, interstate reciprocity is unlikely to achieve a uniform national platform. Nonetheless, we do strongly support the NAIC's very great reform efforts and will continue to work closely with President George Nichols and his colleagues.

Congress should enact a thoroughly modern, market-oriented Federal insurance system to promote positive reform in the States. The case for reform is compelling.

First, and most obviously, we now have a truly national market for financial services. In each State, to do business, an insurer must be separately qualified, its agents separately licensed and its products and forms separately reviewed and approved under the laws of that State.

The NAIC has promoted model laws, but 51 distinct jurisdictions must enact them. Each State is free to modify the model act terms and often does so. Each separate law is then separately interpreted by the insurance department and courts of that State.

Legal similarity is, in practical terms, far from legal uniformity or certainty. The absence of uniform products and rules, the multiplicity of licensing and filing requirements, and the resulting inability of insurers to offer uniform products in a timely manner in response to market needs inevitably add cost and burden to both providers and consumers.

Second, insurance is a trillion-dollar business that should operate a seamless, uniform regulatory structure. A Federal functional regulator is an obvious option that deserves serious consideration. Insurance touches virtually every household in this country. It is thus striking and disturbing that no single national agency has overall expertise in insurance.

An agency with in-depth industry knowledge of insurance products would serve a number of important policy goals—effective consumer protection, strong prudential supervision, the prevention and management of financial crises, and the fostering of private sector innovation.

Third, resources are a significant issue in a State-only system. Despite the best efforts of the NAIC and the States, the quantity and quality of insurance department staff varies widely among the States. A Federal insurance regulator would have, for example, the resources to be an effective and sophisticated regulator of solvency and multinational companies.

Fourth, in regulation, as in the marketplace, lack of competition can breed inefficiency and stand-pat attitude. Competitive choices promote and enhance innovation, efficiency, quality and governmental performance, benefiting both regulated companies and customers. A dual Federal-State system produces a creative and productive tension that tends to improve the quality of regulation and the business options available to the private sector. Ending the State monopoly and insurance regulation will strengthen the entire system and our economy.

And finally, in insurance, unlike other financial services sectors, there are no legacy systems at the Federal level.

Consideration of new Federal regulatory framework provides a truly unique opportunity. In designing a new Federal regulatory framework, we do not have to reengineer or reform. We have the opportunity to create a brand-new system, responsive to the rapidly changing marketplace.

In closing, I want to thank you, Mr. Chairman, for holding this very important hearing and for your commitment to fully explore this issue. We look forward to working with you over the coming months, and would be delighted to answer any questions you might have.

[The prepared statement of John G. Turner follows:]

PREPARED STATEMENT OF JOHN G. TURNER, VICE CHAIRMAN, ING AMERICAS

Chairman Oxley, Ranking Member Towns, and Members of the Committee, I am John G. Turner, Vice Chairman, ING Americas. ING Americas is part of Amsterdam-based ING Group. We are one of the largest integrated financial services organizations in the world with over $400 billion in assets under management. ING Americas is composed of ING's integrated financial services operations in North America and South America. The region consists of more than 25 businesses.

On May 1, 2000 ING entered into a definitive agreement to acquire ReliaStar Financial Corp. The deal was completed on the first of this month. I served as Chairman of the Board and CEO of ReliaStar. ING US Financial Services offers individuals and institutions: life insurance and annuities; employee benefit products and services; life and health reinsurance; retirement plans; mutual funds; bank products; and, personal finance education.

My career in the financial services industry spans more than three decades. During that time, I have witnessed numerous changes at not only my company, but across the entire financial services industry. Today, we are at a critical moment in our industry's history.

The Financial Services Roundtable very much welcomes this opportunity to testify before you on a major piece of unfinished business in the modernization of the American financial system—the creation of an optional federal insurance charter that will parallel the national banking charter. Global competition, the integration of the financial services industry under Gramm-Leach-Bliley, and the emergence of the "wired" consumer on the Internet lead to the inescapable conclusion that this task is timely—indeed, long overdue.

The Financial Services Roundtable actively supported enactment of last year's Gramm-Leach-Bliley Act. While that was indeed an historic achievement, it did not complete the task of financial modernization.

The Roundtable brings an important perspective to the present discussion because it is now a financial services association, not just a banking association. Our evolution parallels the emergence of a national financial services industry. The Roundtable is a national association whose membership is reserved for the 100 largest diversified financial services firms, including banks, insurance companies, and securities firms. The Roundtable supports the goal of pursuing the creation of a modern, national insurance charter while retaining and improving the option of insurers to be regulated through a state-based system.

Let us emphasize at the outset that the Roundtable strongly favors effective and efficient regulation, regulation that is market based and serves consumer needs in a competitive and innovative environment.

There has never been a broader consensus on the need for major structural improvement in the regulation of insurance. Through two decades of rapid financial, technological and market changes in the financial services industry, reforms in the state system unfortunately have failed to provide the consistency and flexibility necessary to adequately respond to these changes and consumer needs. The existing state system may not be "broken," but it clearly has fundamental problems. All the national insurance trade associations recognize this, as does the National Association of Insurance Commissioners (NAIC), evidenced by its own wide-ranging State Regulation 2000 initiative. Efforts to develop a seamless, functionally more efficient state regulatory system are underway, and the Roundtable supports these efforts.

However, simply improving the state insurance system given us by the past may not be sufficient for those insurers that compete directly with other financial services firms on a national level. State reform can come, but with 51 regulators, interstate reciprocity is unlikely to achieve a uniform national platform. As I stated earlier, we strongly support the NAIC initiative and will continue to work closely with NAIC President George Nichols and his colleagues.

Similar to the state/federal banking system, giving insurers the option of regulation under either a properly structured optional federal insurance charter or a state-based system will optimize their ability to serve the economy's future needs by creating a healthy competitive environment that fosters innovation and market efficiency. The recent action by the American Council of Life Insurers to support both reforms takes exactly the right approach, and we applaud them.

The Roundtable believes that our task is to design an insurance regulatory structure consistent with Gramm-Leach-Bliley and the global financial services marketplace while maintaining and enhancing consumer protections. We have the opportunity to build from scratch a state-of-the-art, twenty-first century structure to serve the existing, but still growing and evolving, financial services industry. To do less will compromise the U.S. financial services industry relative to its foreign competitors and, more importantly, ill serve American consumers.

THE CASE FOR THE OPTIONAL FEDERAL CHARTER

Congress should enact a thoroughly modern market-oriented federal insurance system to promote positive reform in the states. In the past, financial reform has often been impelled by a crisis. There is no crisis now, and we should not wait for one. The case for reform is compelling.

First, and most obviously, we now have a truly national market for financial services. Of all the financial services companies, only insurance is predominantly regulated on a state-by-state basis. In each state, to do business, an insurer must be separately qualified, its agents separately licensed, and its products and forms separately reviewed and approved under the laws of that state. The NAIC has promoted model laws, but 51 distinct jurisdictions must enact them. Each state is free to modify the model act terms, and often does so. Each such law is then separately interpreted by the insurance department and courts of that state. Legal similarity is in practical terms far from legal uniformity or certainty. Multiplicity and inconsistency are inevitable.

The absence of uniform products and rules, the multiplicity of licensing and filing requirements, and the resulting inability of insurers to offer uniform products in a timely manner in response to market needs inevitably add cost and burden to both providers and consumers. Inefficiencies and lack of flexible rules in many insurance departments can compound the problem by failing to respond, in an adequate and timely fashion, to insurers' innovative attempts to meet marketplace demands. This problem is exacerbated by the proliferation of complex hybrid products combining elements of securities, banking and insurance. This phenomenon will only increase as the Internet and other technologies drive the marketplace.

Gramm-Leach-Bliley has given rise to a striking example of how the state system works to the disadvantage of the insurance industry in a nationwide financial services economy. This new law includes demanding privacy provisions that require all financial services companies, including insurance firms, to develop substantial compliance and disclosure programs. This major set of tasks will take many companies more than a year to complete. In early March, seven federal regulatory agencies coordinated to issue essentially the same proposed rules, which were then promulgated as substantially identical final rules. The federal agencies also have provided practical relief by making compliance with these rules voluntary for the banking, securities, and other non-insurance financial services firms under their jurisdiction between November 2000 and July 2001.

In contrast, the NAIC in mid-June released a draft model state regulation for comment. After the comments have been received and digested, a final model rule must then work its way through the NAIC committee and board review process before being officially released. Of course, final NAIC model rules will not automatically take effect in any state. Each of the 51 insurance departments must decide what it can issue and when. Each must also decide whether it can and will provide compliance relief until July 2001 parallel to what the federal agencies have announced and the NAIC has recommended. Obviously, the timetable for insurance is going to be much tighter than for any other "financial" services company, all of which already know the rules with which they must comply. The failure of the state system to produce timely rules has left insurers in regulatory limbo and will give many too little time to comply. We cannot wait for them to play catch-up. To be sure, the marketplace won't wait.

Second, insurance is a trillion-dollar business that should operate under a seamless uniform regulatory structure. A federal functional regulator is an obvious option that deserves serious consideration. Insurance touches virtually every household in this country. It is thus striking—and disturbing—that no single national agency has overall expertise in insurance. To be sure, a number of federal agencies, including the Securities and Exchange Commission (SEC), the Labor Department, and the Federal Emergency Management Agency (FEMA), understand important aspects of the insurance business. However, this expertise is fragmented and incomplete.

This industry and the economy generally would benefit from the presence of an agency with in-depth industry knowledge of insurance products within the national government. The integration of financial services organizations and financial products and globalization of all financial markets increases the need for a federal agency expert, if not advocate, regarding insurance. As we have seen in banking and securities, such an agency serves a number of important policy goals: effective consumer protection, strong prudential supervision, the prevention and management of financial crises, and the fostering of private sector innovation.

Third, resources are a significant issue in a state-only system. Despite the best efforts of the NAIC and the states, the quality and quantity of insurance department staff varies widely among the states. A federal insurance regulator would have, for example, the resources to be an effective and sophisticated regulator of solvency

Moreover, as American insurers expand internationally to serve an increasingly global financial marketplace, they will need a credible home country regulator. It will be difficult for states to serve as an effective regulator of multi-national companies.

Fourth, in regulation as in the marketplace, lack of competition can breed inefficiency and stand pat attitudes. Competitive choices promote and enhance innovation, efficiency and quality in governmental performance—benefiting both regulated companies and customers. A dual federal-state system produces a creative and productive tension that tends to improve the quality of regulation and the business options available to the private sector. Indeed, the NAIC's SR2000 initiative itself suggests the merits of a dual system, because it clearly responds to the movement among insurance companies to develop a federal charter option. Ending the state monopoly in insurance regulation will strengthen the entire system and our economy.

In the dual banking system, recent history is replete with examples. Without belaboring the point, undoubtedly the healthy competition between the Federal Reserve and Comptroller of the Currency (OCC) has permitted innovation in the marketplace. "Wild card" statutes enacted at the state level (which allow state banks to engage in all national bank activities without an explicit and specific state authorization) further illustrate the point. The prominence of state chartered banks in New York and Alabama and the vitality of the state banking system across the country five years after national banks gained interstate branching authority demonstrate that states can and do effectively provide a competitive alternative.

Finally, in insurance, unlike other financial services sectors, there are no legacy systems at the federal level. Consideration of a new federal regulatory framework provides a unique opportunity. In designing a new federal regulatory framework, we do not have to re-engineer or reform. We have the opportunity to create a new system responsive to the rapidly changing marketplace. We need not, for example, perpetuate an outmoded system of rate and form regulation. It will be possible to incorporate the best in the state system, and at the same time modernize based on a contemporary appreciation of the power of market solutions and a full understanding of the implications of technology and the innovations that have occurred in the financial markets.

In closing, I want to thank you, Mr. Chairman, for holding this important hearing and for your commitment to fully explore this issue. We look forward to working with you over the coming months. I will be delighted to answer any questions you might have.

ISSUES IN DEVELOPING A MODERN FEDERAL-STATE INSURANCE STRUCTURE

While the case for a federal chartering option is compelling, we have no illusions about the substantive and political difficulty of enacting such a law. Gramm-Leach-Bliley demonstrates that reform of the financial regulatory structure can occur without a crisis or sense of overwhelming problems, but that financial modernization legislation takes a long time and is not easy. Experience also suggests that as a bill moves through Congress rigorous and spirited debate and the crafting of concrete answers will not only improve the bill, but also have the salutary effect of stimulating reforms at the state level.

As we will sketch out briefly, a large number of issues must be resolved.

1. Nature of the Federal Charter Alternative

Perhaps the most basic question is whether the new federal insurance system should be completely federal or whether it should leave national companies subject to some state law. One suggestion might be to couple enactment of a new federal system with amendments to the McCarran-Ferguson Act that would provide federal enhancements to foster a more seamless state-based system for multi-state insurance providers that remain state chartered.

The answers to these basic questions will establish the outlines of the entire system. At this early stage in the debate, the Roundtable has not determined its position on this set of issues. At the moment, we are inclined to recommend testing the proposition that the immediate goal should be a complete, free-standing federal charter system, including a federal guaranty arrangement.

The Roundtable recognizes that the insurance business and insurance regulation has considerable commonality across lines (property and casualty, health, life) and thus, any proposed alternative charter should extend to all lines.

2. A New Federal Regulator

A number of federal options and models already exist for the insurance chartering agency: (1) A new insurance bureau within an existing cabinet department; or (2) A new independent agency.

Related issues are whether it should issue only a single type of charter, authorizing the charter recipient to engage in all types of insurance activities (including life, health, p&c) or separate charters for specified lines of business. Determination of appropriate entry standards and requirements for both new charters and changes in control will be a critical initial task.

Further, if a guaranty arrangement applying federal insurance law is to be established, should it be independent of the chartering agency? An independent agency?

The possibility of creating a self-regulatory organization (SRO) and its scope of responsibility should be considered. Market conduct and consumer protection, including the licensing and supervision of insurance producers, might be appropriate. Gramm-Leach-Bliley included provisions that will lead to the establishment of a National Association of Registered Agents and Brokers (NARAB) in three years unless a sufficient number of states enact state agency laws permitting interstate agency operations on a reciprocal basis. The NAIC's SR2000 initiative seeks to obviate the need for NARAB by meeting this deadline.

Finally, the issues of which courts will have jurisdiction to resolve disputes involving federally regulated insurers and which law will be applied must be resolved. Federal courts might be granted jurisdiction over federally regulated entities and if so must determine what substantive law to apply (i.e. federal law, state insurance law or a combination of the two).

3. Consumer Protection Issues

Consumer protection is an integral part of state regulation and strong consumer protections will necessarily be part of a federal charter structure. A federal charter offers many benefits to consumers, such as nationwide application of the laws and uniformity of application across state lines. Additionally, the legislation could provide consumers with a list of prohibited insurance sales, underwriting, and claims practices. This would give consumers upfront confidence that insurers must act properly or face penalties. Further, a federal market conduct system could be established which would provide periodic marketplace "check-ups" to identify inappropriate and illegal activities by companies.

4. Solvency Regulation

A core function of the federal regulator will be solvency regulation. A threshold issue is whether the existing state risk-based capital regime should be adopted as-is, or rethought. One point of reference would be the capital standards of the European countries. The question of an early warning system for insurer weakness should be considered. The banking "prompt corrective action" regime tied to capital levels is an option to consider, but may not be the most appropriate model.

Risk-oriented examinations and supervision are being used increasingly for major banking organizations, with far less attention to the traditional asset-based "snapshot" on-site examinations. Creation of a federal charter should include a thorough consideration of the most appropriate types of examination for each type and size category of insurer.

5. Addressing Insolvencies

Effective solvency regulation should make insolvencies a rare occurrence, but should they occur the principal choice is whether federally chartered companies should be subject to the guaranty system under federal insurance law or state insurance law. If federal insurance law is applied, the question then is whether state-chartered insurers might participate in it, as an alternative to participation in any state arrangement. One possible federal "backstop" mechanism would be an assessable mutual reinsurance company. Federal solvency oversight would presumably follow, as is the case today with insured state banks. Another option would be to establish a federal bankruptcy regime for federally chartered insurers.

Proponents of applying federal insurance law argue it makes the federal charter more attractive and should serve to enhance the stature of federal insurers as they expand internationally. It also would go hand-in-hand with the regulation of federal insurers. In view of the continuing debate over federal deposit insurance, lender of last resort issues, and the possibility of Treasury funds as the ultimate backstop, and the potential impact on existing state guaranty systems, this topic should be thoroughly analyzed.

As the Congress debates the merits of creating an optional federal charter for the insurance industry I want to underscore the following point. There can only be one guaranty structure for the industry. In the area of solvency, single supervision and implementation is imperative.

6. Holding Company Issues

The threshold question is whether any federal insurance holding company regulation or supervision is needed at all, particularly in light of the availability of financial holding company status under Gramm-Leach-Bliley or savings and loan holding company status under the Home Owners Loan Act.

Affiliate transaction rules to protect the integrity of an insurance company affiliate and the interests of policyholders would be necessary. It has also been suggested that an insurance source of strength policy be adopted that would parallel the one in bank holding company law for the benefit of bank subsidiaries. Neither of these require full holding company regulation. If a federal mutual insurance company charter is to be created, then a mutual insurance holding company statute should be considered as a corollary.

7. A System that Places Maximum Reliance on Competitive Markets

Insurance is a highly competitive field, and experience has shown that reliance on the market is the best way to give consumers good insurance products at fair prices that reflect the risks involved. However, compared to other financial sectors, insurance is in many ways subject to burdensome and time-consuming over-regulation. In banking and securities, twenty years ago Congress removed rigid, prescriptive regulation that prevented firms from being able to respond to consumer needs. These changes benefited consumers through better prices, wider product offerings, and more responsive providers. In insurance, Illinois has shown the way through a market-based system for determining insurance prices and products. That state has one of the most competitive, pro-consumer insurance environments in the United States. That is a model to be studied in the development of a new federal system. We would note that in conjunction with the creation of a competitive, market-based federal system, existing federal insurance antitrust laws should be reconsidered to determine how best to extend certain needed limited antitrust protections to federally-chartered insurers.

If markets are allowed to flourish with rates and coverages established by competition, the need for government-mandated involuntary or residual markets will be greatly reduced because most individuals or businesses seeking insurance will have already obtained it in the market. On the other hand, it has been demonstrated that politicized (as opposed to risk-based) pricing can destroy the voluntary market. If competitively determined actuarially based rates are the focus of any federal insurance charter, then residual market issues will be minimized.

8. Taxation

State and federal tax issues must be considered. Federal charter reform should be tax neutral as far as the states are concerned.

9. Transition Period

Implementing these changes will require some time especially with respect to issues such as creating the proper backstop mechanism for insolvent insurers.

The Financial Services Roundtable urges the Committee to begin actively developing legislation creating a federal insurance charter and agency and to modify the McCarran-Ferguson Act to maximize the ability of the states to modernize the state insurance regulatory system. This is the next major task for financial modernization, and the needed legislation must be developed from a *financial services perspective.* The Roundtable with its diverse membership is especially well-suited to work with the Committee and other interests to craft legislation that we can all be proud of. We stand ready to do so. Thank you for your time and attention.

Mr. OXLEY. Thank you, Mr. Turner.

Mr. Nabers.

STATEMENT OF DRAYTON NABERS, JR.

Mr. NABERS. Thank you, Mr. Chairman. The ACLI is the principal trade association for life insurance companies. From our perspective, your hearing is quite timely, and we very much appreciate your interest and involvement.

My message this morning is simple and urgent. The insurance business is a vital component of the U.S. economy. It provides a wide array of essential financial and retirement security products and services to all segments of the American public. However, for our business to remain viable and serve the needs of our customers effectively, the present system of insurance regulation must become far more efficient.

Please don't misconstrue our agenda. We are not seeking less regulatory oversight. Effective consumer protections are absolutely essential to us. So is appropriate regulation of company solvency.

What we are calling for is much more efficient administration of the statute's rules and regulations to which we are subject. The current regulatory environment is unacceptable. That is a consensus within almost all quarters of the insurance industry, and it is a consensus that we believe is broadly shared by our regulators.

As the financial marketplace has evolved, our system of insurance regulation has not kept pace. The present system was instituted at a time when insurance was not even deemed interstate commerce. As a consequence, many of the underpinnings contemplate companies doing business only within the borders of a single State. Today, most life insurers do business in multiple jurisdictions, if not nationally or internationally.

The most serious problem we confront is the difficulty in bringing new products to market. Life insurance must get new products and disclosure statements approved on a State-by-State basis. For a product to be introduced nationally, there are 51 different laws with their accompanying regulations to be complied with. The process of getting approvals for national distribution is extremely costly, cumbersome and enormously time consuming. It can take a year or more to complete, and in some instances, considerably longer.

There are a number of other significant problems with the current regulatory system, including agent licensing, company licensing and market conduct examinations. These and other concerns are identified and prioritized in the material at the end of the written statement we have submitted.

After more than 2 years of study, the ACLI board of directors reached a decision in June on how to move ahead with its regulatory reform efforts. Its decision was to address the issue on two tracks, each with an equal and very high priority. Under the first track, the ACLI will redouble its effort to work with the States and the NAIC to modernize the State-based system. Under the second track, the ACLI will develop draft legislation providing for an optional Federal charter of life insurers, such as Mr. Turner discussed. No decision has been made on how to proceed once that drafting process is completed.

Let me say a few words about what the ACLI is doing on each of these tracks. First, the NAIC must be commended for its effort this year to overhaul and modernize the State insurance regulation. Over the last year, I have had the singular pleasure to work closely with Kentucky Insurance Commissioner and NAIC President, George Nichols, who is with us or was with us earlier this morning. Commissioner Nichols has been tireless and courageous in his efforts to forge a consensus among the regulatory community on a comprehensive plan for modernizing State regulation.

The NAIC leadership and many other forward-looking regulators, including Commissioner Covington, who spoke to us earlier, deserve great credit for recognizing the critical need for reform and then taking swift action this year to develop an agenda for change. We realize that the NAIC alone cannot make regulatory reform happen. Governors and State legislators must work hand in glove with their insurance regulators to fashion a regulatory system that promotes efficiency across State lines and enhances important consumer safeguards.

We believe State regulation will always be a fundamental part of our regulatory framework. We intend to work with the States for as long as it takes to see State regulation modernized appropriately.

At the same time, the ACLI board thought it essential to give serious consideration to an optional Federal charter for life insurers. Many of our companies are convinced that the insurance business urgently needs a dual charter system analogous to those presently found in the commercial banking thrift and credit union businesses.

At present, well over 200 ACLI and member company representatives are working on the details of the optional Federal charter legislation. We hope to have the drafting process completed by the end of the year, at which time our board will consider next steps.

As the States and the NAIC move forward, they may conclude that they need the assistance of Congress to achieve the degree of uniformity that they and we seek. The ACLI would support that concept, and we ask that you keep an open mind to it. And we at the ACLI may conclude that it is necessary to present you with a proposal for the creation of an optional Federal charter for life insurers. We ask that you keep an open mind to that possibility as well.

Mr. Chairman, I hope our testimony gives you and the members of the subcommittee a sense of the importance we place on reforming and revitalizing the insurance regulatory system. And I reiterate that we are not seeking to weaken insurance regulation, but rather to make it operate more efficiently.

That concludes my remarks. I would be pleased to answer any questions which you or members of the subcommittee might have. And thank you very much for inviting me.

[The prepared statement of Drayton Nabers follows:]

PREPARED STATEMENT OF DRAYTON NABERS, JR., CHAIRMAN & CEO, PROTECTIVE LIFE INSURANCE COMPANY ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS

Mr. Chairman and members of the Subcommittee, my name is Drayton Nabers, and I am Chairman and CEO of Protective Life Insurance Company and Chairman of the Board of Directors of the American Council of Life Insurers (ACLI). The ACLI appreciates the opportunity to appear before you this morning to present the views of life insurance companies on the subject of insurance regulation and the pressing need to bring our system of regulation into line with the needs and circumstances of today's marketplace. The ACLI is the principal trade association for life insurance companies, and its 435 member companies account for approximately 75% of the life insurance in force in the United states.

My message to you this morning is both simple and urgent. The 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. However, for the insurance business to remain viable and serve the needs of its customers effectively, our system of insurance regulation must become far more efficient. This is not a call for less regulation. It is a call for strong regulation administered efficiently, preserving the paramount importance of effective solvency regulation and appropriate consumer protections.

I would like to cover three points this morning. First, why regulation is so important to us at this juncture. Second, what the ACLI has been doing to assess the current regulatory environment and identify areas that are in need of improvement. And third, the options for improvement we are focusing on and how we are pursuing them.

IMPORTANCE OF EFFICIENT INSURANCE REGULATION

As the members of this Subcommittee can appreciate more than most, the marketplace environment in which life insurers and other financial intermediaries compete has changed dramatically in the past several years. Importantly, the role of regulation in this new competitive paradigm has increased significantly.

Historically, life insurers competed only against other life insurers. Whatever the inefficiencies of insurance regulation, companies incurred them equally. Existing companies had learned how to cope with the unwieldy regulatory apparatus, and potential new entrants almost always looked to existing companies and charters because of the difficulty of creating a new one. The status quo, while often frustrating, did not present insurers with serious competitive problems.

Today, the situation is radically different. Life insurers, as providers of investment and retirement security products, find themselves in direct competition with brokerages, mutual funds, and commercial banks. These non-insurance firms have far more efficient systems of regulation, often with a single, principal federal regulator. Without question, the regulatory efficiencies they enjoy translate into very real marketplace advantages. Our system of insurance regulation now stands as perhaps the single largest barrier to our ability to compete effectively.

In the context of this new competitive environment, insurers' inability to bring new products to market in a timely manner is the most serious shortcoming of the current regulatory system. National banks do not need explicit regulatory approval to bring most new products to market on a nationwide basis. Securities firms typically get regulatory approval for new products in several months. By contrast, life insurers must get new products and disclosure statements approved in each state in which the product will be offered, and different jurisdictions often have widely divergent standards, interpretations, and requirements applicable to identical products. Without question there are individual states that are quite prompt in reviewing a company's product form filings. Others are not. And the problem, of course, is getting approval in multiple jurisdictions, which is extremely costly, extremely time consuming, and can take a year or more—and in some instances much longer.

The advent of Gramm-Leach-Bliley and an increasingly diversified financial services landscape will only intensify concerns in this area. For example, there is evidence that firms having both insurance and securities operations are allocating capital away from the insurance unit due largely to the inefficiency of the insurance regulatory system. New securities products can be brought to market in a more timely and cost-effective manner than their insurance counterparts. Over the long run, the implications to insurers and their customers of these adverse capital allocation decisions are serious, and they can be expected to worsen as consolidation and cross-industry diversification continue.

Even with respect to products such as whole life insurance, which have no direct analog in the banking or securities businesses, we face competition from other providers of financial services for the consumer's attention and disposable income.

Moreover, the costs of regulatory inefficiency are necessarily borne directly or indirectly by the public.

The present state-based system of insurance regulation was instituted at a time when "insurance" was not deemed to be interstate commerce. Consequently, the underpinnings of that system—which remain pervasive today—contemplate doing business only within the borders of a single state. Today, most life insurers do business in multiple jurisdictions if not nationally or internationally. And, the system has been cumulative, with new laws, rules and regulations often added but old ones seldom eliminated. In short, our system of regulation has failed to keep pace with changes in the marketplace, and there is a very wide gap between where regulation is and where it should be.

For many life insurers, making regulation more efficient is now an urgent priority. Companies no longer believe they have the luxury of being able to wait for years and years while incremental improvements are debated and slowly implemented on a state-by-state basis.

ACLI STUDY OF INSURANCE REGULATION

By the late 1990s, life insurers had concluded that it was imperative for the industry to address the issue of regulatory reform. In September of 1998, the ACLI Board of Directors instructed the association to undertake a detailed study of life insurance regulation. The objective of this study was to pinpoint those aspects of regulation—both state and federal—that are working well and those aspects that are hindering insurers' ability to compete effectively and thus in need of improvement. This study broke life insurance regulation down into 35 individual elements (e.g., agent and company licensing, policy/contract form approval, solvency monitoring, guaranty associations, nonforfeiture). Individual elements were then rated based on eight factors (uniformity, speed/timing, cost, objective achieved, necessity/relevance, expertise/capacity, sensitivity to industry needs/views, and enforcement/penalties) and assigned one of four overall "scores" based on the eight factors. The overall scores were excellent, good, needs improvement, and unsatisfactory.

This study was completed in November of 1999 and revealed widespread dissatisfaction with the current regulatory system. No element of regulation was rated "excellent," 14 elements were rated "good," and 21 of the 35 elements received negative scores, with 16 rated "needs improvement" and five rated "unsatisfactory."

Taking into account the problems with the present regulatory environment identified in the first part of the study, a second phase evaluated possible avenues for improvement. While a number of regulatory models were considered, only three were viewed as having significant potential: improving the state-based system; federal (national) standards administered by the states; and an optional federal charter. A forth option, regulation by state of domicile, was considered in some detail, but was viewed as more problematic than the other three. The study drew no conclusions as to which of these options should be pursued.

The study concluded that life insurers generally believe the laws and regulations on the books are necessary and appropriate. However, these laws are seldom uniform across all states and, even where uniform, are frequently subject to divergent applications and interpretations. Having to comply with even uniform laws 50+ times is costly and time consuming. When those laws differ and when interpretations of identical or similar laws differ significantly state-to-state, an insurer's ability to do business in multiple jurisdictions is severely hindered. Given these considerations, the life insurers do not seek diminished regulation. Rather, they seek a far more efficient means of administering the laws and regulations to which they are now subject.

A copy of the ACLI report, entitled "*Regulatory Efficiency and Modernization: An Assessment of Current State & Federal Regulation of Life Insurance Companies and an Analysis of Options for Improvement,*" is being made available separately to provide additional background on this issue.

PRIORITIZATION OF CONCERNS

The ACLI's efforts to modernize the life insurance regulatory system have from the outset been spearheaded by chief executives of our member companies. These executives have set the agendas, orchestrated the activities, and established the priorities. As the ACLI completed its study of regulation, these CEOs concluded that they should prioritize the shortcomings identified in the report for two reasons: first, to explain more precisely to our state regulators which concerns are the most pressing from our perspective, thereby enabling state regulators to better set their own agenda for change; and second, to assist the ACLI in evaluating its own options for regulatory reform.

The ACLI surveyed all its member company CEOs late last year to identify their most prominent concerns about the current regulatory system. Each CEO was asked to categorize all the problem areas identified in the report as a "critical problem," a "major problem," a "minor problem," or "not an issue." They also selected the five elements of life insurance regulation they felt should be the ACLI's top priorities for regulatory reform. And finally they selected the one element of regulation they felt was the most critical problem facing their company.

The following are the principal conclusions drawn from the survey:

- Policy form/contract approval (speed to market) is clearly the one element of regulation CEOs believe is most in need of reform.
- Although the level of concern regarding other elements did not come close to that of policy form/contract approval, CEOs did identify others as in critical need of reform. Over half of the CEOs found agent appointments, agent licensing, replacements, reserving and valuation actuary opinion, market conduct examinations, company licensing, charter authority, advertising, state taxation of life insurance companies, and statutory accounting to be critical or major problems.
- All elements relating to authority to do business were assigned a fairly high priority among CEOs. Elements relating to financial regulation, on average, were assigned a lower priority.

The Executive Summary of the CEO survey is appended to this statement.

ACLI POLICY

In June of this year, the ACLI Board of Directors reached a policy decision on how to proceed with its regulatory reform project. Its decision was to address regulatory reform on two tracks. Under the first track, the ACLI will work with the states and the National Association of Insurance Commissioners (NAIC) to improve the state-based system of insurance regulation. Under the second, the ACLI will develop draft legislation providing for an optional federal charter for life insurers. Both tracks were given equally high priority and are discussed below.

TRACK ONE—IMPROVING THE STATE-BASED SYSTEM OF REGULATION

Improving a state-based system of regulation has never really been an "option" for the ACLI: rather, it is a given. While substantial changes to the present system must be made, regulation of insurance by the states will always be a fundamental part of our regulatory environment.

For this reason, the ACLI Board directed the association to redouble its efforts to work with state insurance regulators, the NAIC, and state legislators to reform state regulation in a way that addresses the shortcomings identified in the ACLI study. The Board made clear that there will be no higher priority at the ACLI. This aspect of our regulatory reform effort is being overseen by a group of company chief executives and is chaired by Sy Sternberg, the chairman-elect of the ACLI and Chairman, President and CEO of New York Life.

This group has worked very closely with the NAIC and its leadership as the states have moved forward to implement their agenda for state regulatory reform outlined in a document adopted earlier this year entitled *Statement of Intent: The Future of Insurance Regulation.* The ACLI and its member companies have been making every effort to provide the NAIC with thoughtful and detailed input designed to help implement this statement of intent successfully. The focus of our efforts is in those areas identified by both the NAIC and the ACLI as particularly important, to wit: product regulation (speed to market); producer licencing; market conduct examinations; privacy; and so-called "national treatment."

From the ACLI's perspective, the yardstick for gauging the success of regulatory reform in the principal areas where change is necessary is quite simple: uniform standards; consistent interpretations of those standards; and a single point of contact for dealing with multiple jurisdictions. Only in this way will insurers doing a national business be able to operate effectively and provide their customers with the products and services they are demanding.

The NAIC and its leadership deserve credit for the way in which they have stepped up to the task of developing a strategy for implementing meaningful reform. In a very short period of time, they have forged a strong consensus among the states for progressive change and set forth a conceptual blueprint for action. While the true measure of success, of course, will be the actual implementation of appropriate reforms, the NAIC has shown strong commitment and effort over the course of the last year.

From the ACLI's perspective, this effort to improve state insurance regulation has no set timetable for completion. While we believe it is imperative to move quickly, we will pursue the goal of an efficient state-based system of insurance regulation regardless of how long it takes to implement.

TRACK TWO—OPTIONAL FEDERAL CHARTER

At the same time the ACLI Board reaffirmed its commitment to improve state regulation, it also directed the association to draft legislation providing for an optional federal charter for life insurance companies. The ACLI Board has not made any decision to seek the introduction and passage of such legislation in Congress once the drafting work has been completed. That decision will be made at a later date taking into account a number of relevant factors.

The decision to draft optional federal charter legislation reflects several different perspectives within our membership. A number of companies believe the insurance business is badly in need of a dual regulatory system analogous to that presently found in the commercial banking, thrift, and credit union businesses. Such a system enables institutions to select a state or federal charter based on the particular needs and circumstances of their operations. For example, companies doing business in multiple jurisdictions might be more inclined to opt for a federal charter so that they will have to deal with only a single regulator. On the other hand, companies doing business in a single state might find a state charter to be far more practical and cost-effective. Other companies are skeptical that at the end of the day individual state regulators and state legislators will be able to cede authority to the extent necessary to implement a system of uniform, efficient state regulation. Although motivations might differ, there is a strong consensus within the ACLI membership that serious consideration of an optional federal charter is a necessary and appropriate step at this time.

As with the effort to improve state regulation, the ACLI's optional federal charter project is being overseen by a group on CEOs, and I chair that group. A comprehensive drafting process is now under way involving well over 200 ACLI and member company representatives. Our goal is to have draft legislation in hand by the end of the year for further consideration by the ACLI Board.

The ACLI's efforts in this regard involve only the details of how the life insurance business should be regulated. While a federal insurance regulator would certainly have the authority to regulate all lines of insurance, the ACLI is deferring to the property and casualty and health insurance businesses for the specific regulatory requirements appropriate to those lines.

CONCLUSION

Mr. Chairman, I hope this statement gives you and your Subcommittee a clear sense of the importance we place on reforming and revitalizing the insurance regulatory system. The current framework is clearly unacceptable, and that fact is generally acknowledged today by regulators and regulated alike.

It is worth reemphasizing that our agenda here is not deregulation of life insurers but more efficient administration of laws and regulations, particularly for companies doing business on a multi-state or national basis. Strong regulation, both in terms of assuring company solvency and providing protections to insurance consumers, is in the best interests of our business in the short and long term. The ACLI fully supports that goal.

In sum, we would be remiss if we did not fully explore all viable alternatives to achieving a more efficient and effective insurance regulatory environment. That is why the ACLI is pursing the issue on a two-track basis. State regulators are to be commended for the progress they are making in addressing the issue. Nevertheless, when achieving meaningful reform entails gaining agreement by more than 50 regulators and legislatures and who will need to cede administrative responsibilities to central decision makers, the challenge is certainly daunting.

As the states move forward, they may conclude they need the assistance of Congress to reach the degree of uniformity they seek. The ACLI would support that concept, and we ask that you keep an open mind to it. By the same token, we may conclude that it is necessary to present you with a proposal for enacting legislation creating an optional federal charter for life insurers. We ask that you keep an open mind to that possibility as well. The need to reform the insurance regulatory system is simply too important to foreclose any reasonable alternatives.

Mr. Chairman, the ACLI again appreciates the opportunity to present the views of its member life insurance companies on the importance of insurance regulatory reform. We would be pleased to provide you and the members of the Subcommittee with any additional information that might be helpful as your consideration of this critical issue continues.

Mr. OXLEY. Thank you, Mr. Nabers.
Mr. Urban.

STATEMENT OF PHILIP H. URBAN

Mr. URBAN. Good morning. Mr. Chairman and members of the House committee, my name is Philip H. Urban. I am President and Chief Executive Officer of the Grange Insurance Companies, and I am testifying today on behalf of the Alliance of American Insurers, the National Association of Independent Insurers, and the National Association of Mutual Insurance Companies, which together represent more than two-thirds of the property casualty insurance industry. I appreciate the opportunity to testify on an issue vital to my company's remaining competitive in today's financial services marketplace.

My company and the others who are members of the three trade associations have been strong proponents of State-based insurance regulation. State regulation is simply the best public policy for the business of insurance and for your constituents.

In my own State of Ohio there are regulatory conditions that are conducive to competition, but at the same time protective of consumers' rights. However, changes in markets and technology demand that State-based insurance regulation be modernized. The States, working with industry and the NAIC, can achieve regulatory modernization. The National Conference of State Legislatures, in partnership with the National Conference of Insurance Legislators, will soon undertake an evaluation of modernization options at the State legislative level.

At its March 2000 meeting, the NAIC adopted a "Statement of Intent" which identified nine areas in State insurance regulation that need modernization. One objective of this work is to make improvements in processes that will result in products being more promptly offered to consumers.

Most States require a property casualty insurer to obtain prior approval from the insurance regulator in order to introduce a new product or modify an existing one. States could resolve this problem today by adopting a market-driven approach to rate and form filings.

The essence of our public policy argument is quite simple. Companies doing business across the country or in a single State need to be able to serve markets with a minimum of difficulty. Open competition regulation would free regulators from the onerous task of approving countless rate and form filings and would shift the focus to monitoring business practices and ensuring that consumers are being adequately served.

Insurers would be able to get new products to markets with fewer impediments, while consumer interests would be protected through more competitive prices, more product choices and a reformed market conduct enforcement system.

Access to markets is another area that needs modernization. The NAIC has a project to create a uniform application form for companies to enter the various State jurisdictions. We support that plan. We strongly believe that access to markets is a desirable State-based regulatory outcome that should be available to every company, not just those companies that meet a specific size requirement and agree to abide by certain operating procedures.

With respect to consumer protections, a new standard for market conduct regulation is an important aspect of a deregulated insurance marketplace. The trade associations have suggested to the NAIC's Market Conduct Issues Working Group a 12-point program to improve the market conduct examination process. A copy is attached to this testimony.

These are challenging tasks. In our view, State regulation needs to be modernized without the creation of a new bureaucracy or a centralization of a regulatory structure that could ultimately impose new costs and requirements on insurance companies.

While we embrace the effort to modernize regulation, there are some concerns. One of these is the subject of privacy. Frankly, we were disappointed by the recent actions of the NAIC Working Group on privacy. That proposal, if adopted by the NAIC, expands the regulatory requirements of insurers by requiring insurance not even mentioned by the Gramm-Leach Bliley act in the area of consumer privacy. This does not meet the overall policy goal of equal treatment for all market participants. We hope that this approach is not one that will be adopted in an other areas.

There is a need for a new paradigm and State regulatory action promoting uniformity and consistent treatment. This model fails that test.

A systematic plan for implementation at the State level, including regulatory and legislative activity, must be established. The NAIC and NCOIL and the NCSL could develop and execute that plan jointly.

The implementation plan should be built around an analysis of the legal requirements of each State and should include a projected timetable for initiating each step based on these State laws. The details of the plan should be public, leaving no question in the mind of regulators, industry, consumers and the Congress that a true plan to implement reform is ongoing. We would expect Congress to continue to monitor progress in the States.

That said, we would point out that we are committed to improving the State-based system of insurance regulation and are prepared to spend our time working toward implementation of these reforms.

In conclusion, the NAIC State insurance commissioners and legislatures should be commended for their work over the past 6 months in identifying the tasks that need to be done to improve State-based insurance regulation. But this is only the beginning. While change is called for, it must be done right. Congress is rightly watching this process, but should not create a stampede toward impractical and unworkable solutions. We are ready and willing to assist State regulators in achieving modernization of insurance regulation by the States.

Thank you.

[The prepared statement of Philip H. Urban follows:]

PREPARED STATEMENT OF PHILIP H. URBAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GRANGE INSURANCE COMPANIES ON BEHALF OF THE ALLIANCE OF AMERICAN INSURERS

Mr. Chairman, and members of the House subcommittee, my name is Philip H. Urban. I am President and Chief Executive Officer of the Grange Insurance Companies, and I am testifying today on behalf of the Alliance of American Insurers (Alliance) and the National Association of Independent Insurers (NAII) and the National Association of Mutual Insurance Companies (NAMIC).

Grange Mutual Casualty Company is a regional multi-line property and casualty insurance company headquartered in Columbus, Ohio. Our company is licensed in 11 states; and in terms of premium volume, we rank solidly within the top 100 property and casualty insurers in the United States. In addition to our property and casualty insurance companies, the Grange family of companies includes the Grange Life Insurance Company and The Grange Bank, a federal thrift. We offer Auto, Home, Business, Life and Banking products exclusively through an independent agency distribution system.

The Alliance represents 325 companies, both mutual and stock, writing over $30 billion in annual premiums.

NAII, of which I currently serve on the Board of Governors, represents approximately 675 property/casualty companies in the United States that write $92.9 billion in annual premiums representing every type of property/casualty coverage, including automobile, homeowners, business insurance, workers' compensation and surplus lines.

NAMIC, of which we are a member, represents nearly 1,300 member companies and about 40 percent or about $118 billion of the property/casualty premium written across the country. NAMIC companies have a long record of service to insurance consumers and their communities—more than half of NAMIC member companies have been in business over 100 years.

I appreciate the opportunity to testify today on an issue vital to my company remaining competitive in today's financial services marketplace: State-based insurance regulatory reforms.

My company and the others who are members of the three trade associations have been strong proponents of state-based insurance regulation. In fact, during last year's debate on financial services modernization, our industry constantly sounded the trumpet of state-based insurance regulation. My company has long believed that insurance regulators should be closest to the companies they oversee and to the consumers they serve. When states regulate insurance, companies enjoy a level of access important to the resolution of conflict; and consumers benefit from a state regulator responsive to their needs. Working effectively, state regulation is simply the best public policy for the business of insurance and for your constituents. In my own state of Ohio, there are regulatory conditions that are conducive to competition, but at the same time protective of consumers' rights. In fact, it is the competition that allows my company and other insurance companies in Ohio, to offer products to consumers at an affordable price.

However, changes in markets and technology demand that state-based insurance regulation would benefit from modernization. Congress has already given consideration to an area of modernization when it adopted the Gramm-Leach-Bliley Act (GLBA), which rightly reasserted the primacy of state regulation.

My company and the other companies I represent today do not see federal regulation as an appropriate approach to modernization of state regulation. The states, working with industry and at the National Association of Insurance Commissioners (NAIC), can achieve regulatory modernization and in fact much activity is being directed to that goal under the leadership of NAIC President, George Nichols, Commissioner of Insurance of the State of Kentucky. The National Conference of State Legislatures (NCSL) in partnership with the National Conference of Insurance Legislators (NCOIL) will soon undertake an evaluation of modernization options at the state legislative level.

At its March 2000 meeting, the NAIC, adopted a "Statement of Intent" which identified nine areas in state insurance regulation for which modernization is needed. Although the NAIC is not empowered to implement reforms by itself, the associations I represent today were pleased that the NAIC recognized the need for change and was committed to developing reforms that could be implemented in the states. In the last six months, the NAIC has made efforts to follow through on the "Statement of Intent."

One objective of this work is to make improvements in processes that will result in products being more promptly offered to consumers. Most states require a property/casualty insurer to obtain prior approval from the insurance regulator in order to introduce a new product or modify an existing one. In addition to product prior approval, rates that determine premiums and rate changes require prior approval. States could resolve this problem today by adopting a market-driven approach to rate and form filings.

The prior approval process is due for change because it was developed in the states at the time the McCarran-Ferguson Act was adopted. At that time, the insurance business was more like a cartel than a competitive business. Rating bureaus set rates that all insurance companies adhered to unless they sought regulatory approval for deviation. There was little creativity in products, and regulation was more important than competition.

But today, competition among insurers is fierce and intense. Companies compete on price and product. Innovation is key to success in the marketplace and also necessary to meet the rapidly changing needs of fast moving business, economic, technology, life style and legal changes that characterize our economy and society today. This marketplace calls for modernized insurance regulation compatible with today and not 1946. It calls for competition to set rates and drive innovation. The role of the regulator needs to evolve to catch up with the evolution of the insurance marketplace.

One of the benefits of state regulation is that it allows for experimentation. One state has experimented with competition as the primary regulator. The experiment took place 30 years ago in Illinois. The experiment worked and Illinois continues to operate under a competitive system with good results. Various analyses show Illinois is a highly competitive state. Products are available, innovation is rapid and citizens pay fair, competitive prices for insurance.

While other states have embraced different versions of competition, many have not. In some states, the regulatory behavior is not always consistent with a commitment to competition. Change is needed in such situations, but a "one-size-fits-all" approach, centrally administered, is not the solution.

The essence of our public policy argument is quite simple. Companies doing business across the country or in a single state need to be able to serve markets with a minimum of difficulty. Inability to do this disadvantages both insurers and consumers. Prior approval of rates and forms frequently takes months to secure, costing insurers valuable marketing opportunities and depriving consumers the advantages of new and improved risk-sharing products. The length of the prior approval process also inhibits the ability of insurers to compete successfully with other, less regulated segments of the financial services industry.

"Open competition" regulation would free regulators from the onerous task of approving countless rate and form filings and would shift the focus to monitoring business practices and assuring that consumers are being adequately served. Insurers would be able to get new products to markets with fewer impediments, while consumer interests would be protected through more competitive prices, more product choices and a reformed market conduct enforcement system.

The NAIC Speed-to-Market Working Group has recently proposed a new entity, the Coordinated Advertising, Rate, and Form Review Authority (CARFRA), to expedite the approval process for the filing of some new rates and forms. This proposal has had little exposure, and it is too early to fully judge it. But it indicates that state regulators see the need to improve the rate and form filing system in many states. The process for dealing with rates and forms is determined by state statute.

In addition to NAIC action, the American Legislative Exchange Council has adopted a model rate and form law that would modernize insurance regulation and allow faster adjustments in the marketplace. NCOIL also adopted a model to improve this process. The two organizations will work to reconcile their respective models. On the issue of model rating laws, the NAIC had a good competitive rating model that is no longer in its repertoire of model laws. The Speed to Market Working Group intends to consider a model rating law and we believe they should consider the work of these legislative organizations.

The NAIC has indicated a commitment to deal with issues relating to the culture of state regulation with a goal of educating the insurance department staffs toward a competition mind-set. We applaud that effort. We think these commitments should provide better responsiveness in rate and product market adjustments to meet the demands and the needs of consumers, accompanied by cost efficient regulation.

Access to markets is another area in which modernization is needed. The NAIC has a project to create a uniform application form for companies to enter the various state jurisdictions. We support that plan. We strongly believe that access to markets is a desirable state based regulatory outcome that should be available to every company, not just those companies that meet a specific size requirement and agree to abide by certain operating procedures. We believe that this will help maintain a more level "playing field" for insurers. Work being done in the states to adopt uniformity or reciprocity in producer licensing, consistent with GLBA, will also help. The NAIC is looking at other ways to moderate or eliminate the state by state burdens of doing business.

With respect to consumer protections, a new standard for market conduct regulation is an important aspect of a deregulated insurance marketplace. The NAIC, through its Statement of Intent process, has agreed to study market conduct regulation. The trade associations have suggested to the NAIC Market Conduct Issues Working Group a 12-point program to improve the market conduct examination process. A copy is attached to this testimony.

Hallmarks of the new standards include elimination of duplicative market conduct exams, creation of more uniform market conduct laws and regulations and adoption of alternative mechanisms to create a more efficient market conduct surveillance system.

Also included is the notion that market conduct exams should be "for cause" only, with remediation as their central purpose. Companies should be allowed to cure business practices deemed deficient to ensure that the needs of insurance consumers are met. And while a "for cause" exam must be thorough, the cost to a company must not be open-ended. Examiners should be subject to reasonable time and cost limitations that will encourage the prompt completion of the procedure.

State regulators are also considering integration of other market conduct techniques such as desk audits, limited scope exams and insurer self-audits to mitigate against the need for states to regularly conduct even "targeted" exams.

These are challenging tasks. In our view, state regulation needs to be modernized without creation of a new bureaucracy or a centralization of a regulatory structure that could ultimately impose new costs and requirements on insurance companies. State regulation can and should be done by the states. While barriers to markets and doing business must be eliminated, it must not be forgotten that for property/casualty insurance products local market conditions affect the product and price. A few of the many examples are tort law, the weather, population density and traffic congestion.

While we embrace the effort to modernize regulation, there are some concerns. One of these is the subject of privacy. Frankly, we were disappointed by the recent actions of the NAIC Working Group on privacy. That proposal, if adopted by the NAIC, expands the regulatory requirements of insurers by requiring information not even required by GLBA in the area of consumer privacy. This does not meet the overall policy goal of equal treatment for all market participants. We hope that this approach is not one that will be adopted in other areas. There is a need for a new paradigm in state regulatory action of uniformity and consistent treatment. This model fails that test.

The key to regulatory modernization is quick implementation of the proposals to meet the demands of the marketplace. The best-crafted reforms will only be as good as the regulatory and legislative strategies to secure their enactment.

Progress will be recognized when fundamental reforms in rate and form regulation, company licensing and market conduct are at work in a majority of states. Many of these reforms will have to be enacted by state legislatures, a difficult activity to coordinate for which results cannot be guaranteed. Other changes to state standards can be put into place by regulators using existing authority.

Either way, a systematic plan for implementation at the state level, including regulatory and legislative activity must be established. The NAIC, NCOIL and the NCSL could develop and execute the plan jointly.

The implementation plan should be built around an analysis of the legal requirements in each state to accomplish them and should include a projected timetable for initiating each step based on these state laws. The details of the plan should be public, leaving no question in the mind of regulators, industry, consumers and the Congress that a true plan to implement reform is ongoing. We would expect Congress to continue to monitor progress in the states.

That said, we would point out that we are committed to improving the state based system of insurance regulation and are prepared to spend our time working toward implementation of these reforms. It is simply our belief that a formal and public strategy be adopted by all the parties who have a role to play in achieving this goal.

In conclusion, the NAIC, state insurance commissioners and legislators should be commended for their work over the past six months in identifying the tasks that need to be done to improve state-based insurance regulation. But this is only the beginning. While change is called for, it must be done right. Congress is rightly watching this process, but should not create a stampede toward impractical and unworkable solutions. Speed and good judgement are both necessary to be balanced. We are ready and willing to assist state regulators in achieving modernization of insurance regulation by the states.

Thank you.

Mr. OXLEY. Thank you.
Mr. Mendelsohn.

STATEMENT OF ROBERT V. MENDELSOHN

Mr. MENDELSOHN. Mr. Chairman, distinguished committee members, my name is Bob Mendelsohn. I am Group Chief Executive of Royal & SunAlliance Insurance. We are a global company based in London. We have been in business since 1710, and we write insurance in 130 countries around the world. I am also Chairman of our U.S. operation, Royal & SunAlliance. I am testifying this morning on behalf of the American Insurance Association, an association of over 370 property and casualty companies.

I moved to London 3 years ago to take on responsibility for a worldwide company. Before that, I spent 4 years as chief executive of a national insurance company here in the U.S.; before that, 20 years with a company working my way up to the position of President and Chief Operating Officer of a group of companies that were regional and specialty companies, operating around the United States. So I have seen the regulatory scheme from the viewpoint of a small regional company, from the viewpoint of a national company, and now from the viewpoint of a global company.

I can tell you, based on my personal experience, that the current regulatory system is broken. It will not serve us well, here in America, into the 21st century, and there is no doubt that reform is called for. The future of our industry depends on a competitive and healthy marketplace, but the regulatory regime we operate in discourages the competition and innovation demanded by the new economy, and it threatens our competitiveness in a world economy. I think fundamental change is long overdue.

The current system single-mindedly focuses on government price and product controls separately created and administered in each State. This discourages innovation, it discourages competition and it leaves insurers at a disadvantage compared to federally regulated financial services. A subset of this problem is the sheer time it takes here in America to get products and forms approved. There are better ways.

Individual State regulatory requirements are also frequently inconsistent with each other. It increases compliance costs, discouraging technical innovation and makes it difficult for insurers to service customers when we operate in different States.

Individual State regulatory requirements are also inconsistent with the growing use of the Internet. I think in the technology world the consumers will see the best products and prices on offer from companies operating here in the States and all over the world, and will insist upon a regulatory system that allows them access to the best price and the best product.

American Insurance Association members have long been struggling with these issues, and we are convinced that the answer rests with market-based approaches to regulation. Our efforts have been guided by the end belief that there must be an insurance regulatory structure that provides better service to the insurers and to the economy and to consumers.

What should that system look like? Here are our principles of reform:

First, market and consumer demand, not command and control regulatory fiat, should dictate the products sold and the prices charged.

Second, companies should have the option to obtain a single charter that would allow them to do business nationally.

Third, insurance companies that operate across State lines should be able to count on uniform, one-stop regulation that focuses only on those areas where an ongoing regulatory role serves the public interest.

Regulatory requirements should be enforced in a timely, impartial and professional manner. Insurance companies should be able to operate on a level playing field vis-a-vis the other financial services firms that provide similar products to our global competitors and the alternative market.

And finally, the regulatory system should embrace and encourage the use of new technologies by insurers in every aspect of their business. I think that a regulatory system based on those principles will free up government resources, will allow State insurance departments to direct their attention to where it is most needed, which is effective solvency regulation, rehabilitation or liquidation of troubled companies and the prevention of frauds, such as the ones referred to by Congressman Towns earlier this morning. It will free up a tremendous amount of government resources presently devoted to rate and form regulation.

We support the NAIC's efforts. This last March, the NAIC overwhelmingly approved forward looking statements of intent on insurance regulations. We share their goals to modernize insurance regulations to meet the demand of our new marketplace, and we applaud the spirit of their effort and have provided substantive input. However, we anxiously await that State blueprint, perhaps by December of this year, so we can measure their recommendations against the AIA principles for reform, which I outlined this morning, and to determine whether additional State or Federal action is warranted.

We know the market is not going to wait for us. If we don't act soon, we might just find ourselves irrelevant in the future marketplace.

Thank you, Mr. Chairman, for this hearing this morning and we would urge you to keep the heat on.

[The prepared statement of Robert V. Mendelsohn follows:]

PREPARED STATEMENT OF ROBERT V. MENDELSOHN, GROUP CHIEF EXECUTIVE OF ROYAL & SUNALLIANCE

Chairman Oxley, my name is Robert Mendelsohn and I am Group Chief Executive of Royal & SunAlliance, a global insurance group writing more than $17 billion in insurance premiums worldwide and employing more than 7,000 in the United States. As immediate past chair of the American Insurance Association, which represents over 370 property casualty insurers, I want to thank you for the opportunity to testify before this Committee.

For AIA members, insurance regulatory reform is, and will continue to be, a key concern. The ability of insurers to bring products to market in a timely and cost-effective manner, along with uniform regulatory treatment regardless of where they are domiciled and where they do business, is critical.

Insurance regulation is not a new topic for this Committee or for Congress. Several times in the past, internal industry forces (including those surrounding the liability crisis of the mid-1980's or the solvency concerns of the early 1990's) led to a review of the system at both the state and federal level. What is different now is that external forces, including a new era of global markets and financial services modernization, are propelling the examination.

But this isn't just about changes in the marketplace following the critical enactment of Gramm-Leach-Bliley, or the specter of federal regulation—it is fundamentally about the ability of insurers to survive, and thrive, in the 21st century. Insurance industry mergers and acquisitions, convergence of the various financial services industry sectors, globalization, and technology have altered the economic and operational landscape in which AIA members do business. Yet, the insurance regulatory environment has remained stagnant or, worse, has grown increasingly bureaucratic. For every incremental movement toward greater efficiency or uniformity, there are many new state-specific regulatory requirements that result in cost, delay, and frustration for insurers—with little or no consumer benefit. A fundamental change in perspective is long overdue.

Recognizing that the long-term best interests of policyholders, insurers, and the overall economy are served by an efficient, effective regulatory system, AIA has spent the last twelve months examining the "value chain" associated with the regulation of insurance companies and products and identifying opportunities—based on both domestic and international regulatory models—to remove current regulatory impediments to competition, thus creating greater value for all stakeholders.

From that discussion and analysis of the current regulatory system, several themes emerged:

- An entrenched state focus on government price and product controls, which discourages product innovation and competition.
- In many states, a chronic and growing delay in regulatory rate and form approvals. Other federally-regulated financial services industries have no similar regulatory obstacles to getting products to market quickly.
- Inconsistency among state statutory and legal requirements and the administration of state systems. The need to meet differing regulatory demands in each jurisdiction increases compliance costs, discourages technological innovation, and makes it difficult for insurers to service customers doing business in more than one state.
- Incompatibility of the state-based regulatory system with emerging technologies. A regulatory system dependent on state-by-state price and product controls is inconsistent with new, expanding technologies such as the Internet, a medium that recognizes no state or federal boundaries.

These themes underlie guiding reform principles adopted by the AIA earlier this year:

ELIMINATION OF PRICE AND PRODUCT OBSTACLES. Market forces, rather than regulatory approvals, should dictate the products sold by insurers and the prices they charge.

OPTIONAL NATIONAL CHARTERING. Companies should have the option of obtaining a single charter that would allow them to do business in all regulatory jurisdictions. States must not discriminate against such companies in favor of those that obtain licensing on a state-by-state basis.

UNIFORMITY. Insurance companies that operate in multiple jurisdictions should be subject to one stop, non-duplicative regulation and uniform laws governing only those areas where an on-going regulatory role serves the public interest, including market conduct activities, agent licensing, claims practices, solvency, and liquidation.

TIMELY AND FAIR ENFORCEMENT. Regulatory requirements should be enforced in a timely, impartial, and professional manner, and fines and other penalties should be proportional to the violation at issue.

LEVEL PLAYING FIELD. Insurance companies should be able to operate on a level regulatory playing field vis-a-vis other financial services firms that provide similar products, global competitors, and the alternative market.

TECHNOLOGY-FRIENDLY REGULATION. The regulatory system should embrace the use of new technologies by insurers in every aspect of their business.

Regulation that embraces these principles will benefit consumers, insurance companies, and insurance regulators in several ways:

First, regulatory reform (especially elimination of government price and product controls) frees up government resources and allows state insurance departments to redirect regulatory attention where it is most needed, including effective solvency regulation and rehabilitation or liquidation of troubled companies. A sharper regulatory focus is particularly important in states under fiscal constraints or attempting to downsize their governments. Ultimately, consumers also benefit from a streamlined and efficient insurance regulatory system that reduces regulatory costs for insurers.

Second, product innovation will be enhanced if insurers are able to bring new coverages to market more quickly because they do not face extensive regulatory delays getting those coverages approved by the state regulator. Faster product introduction will also allow insurers to better serve the changing needs of individuals and businesses. In addition, in the new world of Gramm-Leach-Bliley, creative new products, representing a more integrated financial services sector, will emerge. Lengthy rate and form approval processes that are applicable to "insurance products" within the scope of the Gramm-Leach-Bliley Act will hinder insurers' ability to compete effectively with banking and securities firms that operate without these constraints.

Third, regulatory reform will make the purchase of insurance easier and less costly for policyholders. Further, a streamlined commercial lines regulatory system would attract risk financing capital, including insurance capital, back to the U.S. from various off-shore jurisdictions to which it has migrated due, in part, to less restrictive regulatory environments. U.S. insurers will then be able to compete more effectively with alternative risk financing mechanisms, including securitization.

Fourth, regulatory reform will encourage more insurance companies to enter new markets, enhancing competition and therefore producing greater availability and lower prices.

Recognizing these benefits, AIA has been actively engaged in advancing the elimination of government rate and form controls on a state-by-state basis for a number of years. Most states are moving very cautiously. Due to political opposition from certain local interests, regulatory reform efforts have not been as sweeping as the external economic environment demands, and there are significant variations among states that make it more difficult for regional, national, or global insurers to operate on a uniform basis.

The forces of modernization, industry consolidation, advances in technology and globalization are widely acknowledged by industry leaders represented on this panel, but they are also acknowledged by the industry's regulators. This past March, the National Association of Insurance Commissioners overwhelmingly approved a forward-looking "Statement of Intent: the Future of Insurance Regulation." In conjunction with this undertaking, nine new working groups were created—five to address implementation issues arising from the Gramm-Leach-Bliley Act and four to drive the NAIC leadership's regulatory reform priorities.

The Statement of Intent declares that state insurance regulators must modernize insurance regulation to meet the realities of an increasingly dynamic, and internationally competitive, insurance marketplace. NAIC President George Nichols, who spearheaded the effort and appeared before this Committee in July, has announced publicly that if state regulators cannot meet this challenge within the next year, the door may be open to federal regulation. Although there is no "official" NAIC deadline or clear definition of success, various NAIC sources have indicated that regulators will produce a blueprint for reform no later than December 2000, if not earlier. Indeed, as the Committee has heard this morning from Ohio Director Lee Covington, progress is being made at the NAIC on these issues. Director Covington himself is playing a key role in the speed to market effort.

AIA applauds the spirit of the NAIC effort, and we have provided substantive comments to virtually all of the Working Groups. "Speed to Market"—i.e., the ability to bring products to market in a timely and cost-effective manner—and "National Treatment"—i.e., uniform regulatory treatment for national companies—have been focal points of our efforts. We will continue to work with the NAIC to produce needed regulatory reform in these and other areas.

As mentioned earlier, AIA favors a market-based approach to insurance regulation that does not rely on prior government review or approval of prices or products, but permits competitive forces to respond to consumer demand. The time to implement this approach is now, as financial services modernization is evolving—not later when the size, shape and grade of the financial services playing field will largely be determined. AIA urges this Committee to hold the NAIC to a timetable, to encourage it to move quickly towards a more efficient, beneficial, and market-oriented system, and to be prepared to act if the state regulatory system fails to modernize itself. AIA also will be evaluating the NAIC's blueprint for reform against our own regulatory reform principles to determine whether additional state or federal action is warranted.

Many will attempt to define this effort as a debate over state versus federal regulation. We reject that. It is not about who regulates. It is about real reforms that are necessary if we are going to remain a competitive, vibrant industry. The marketplace isn't going to wait for us. Inaction and complacency about insurance regulatory reform will render the industry outdated and possibly irrelevant.

Again, I commend the Committee for holding this hearing and I thank Chairman Oxley for the opportunity to speak today on an issue that is of critical importance to the insurance industry and the constituents it serves.

Mr. OXLEY. Thank you, Mr. Mendelsohn.

Mr. Milesko.

STATEMENT OF GLEN J. MILESKO

Mr. MILESKO. Good morning, Mr. Chairman. I am chief executive officer of Banc One Insurance Group, and I am here today on behalf of American Banker's Associations Insurance arm, also known as ABAI. ABAI's members are banking organizations engaged in the business of insurance. My own company is one of the country's leading bank insurance programs that represents over 5 million policyholders nationwide, generating annual premium sales in excess of $2 billion, claim payments of $75 million, and revenues exceeding $500 million. In the time allotted to me this morning, I will explain why ABAI supports optional Federal chartering for insurance companies and agencies, and I will outline some of the key features of our proposal, which is based on the dual banking system.

ABAI supports Federal chartering of insurance companies and agencies because we believe that Federal chartering would benefit consumers by permitting more uniform policies, greater product choice, price competition, and increased product availability and mobility. It would stimulate competition in the insurance industry to the benefit of the industry and consumers. It would enhance the quality of insurance regulation while maintaining the integrity of the State system, and it would provide more uniform, consistent and comprehensive regulation for larger insurance companies and agencies.

Let us take a closer look at these benefits. Benefit No. 1: Optional Federal chartering would enhance the delivery of insurance to consumers. While State regulation of insurance is a long and commendable history, it imposes many impediments on the delivery of insurance. For example, every State has varying levels of prelicensing requirements. Every State has different customer collateral forms and filing requirements. Most States have specific and different rules for each insurance product type and distribution method. Existing State regulations also inherit the development of new products and e-commerce delivery where a real sense of urgency is required. Under our proposal, none of these impediments would apply a federally chartered insurance company or agency.

Benefit two, optional Federal chartering would stimulate competition in the insurance industry to the benefit of both consumers and the industry. Some State insurance laws inhibit competition. State anti-rebating laws are an example, so are State rate laws. Our proposal would stimulate competition in the industry by allowing premium rates to be set by the market and by permitting rebates.

Benefit number 3: Optional Federal chartering would enhance State regulation. The dual banking system has resulted in healthy competition between State and Federal banking regulators. Moreover, that competition has not diminished the role of State regulators. Today, State banking departments charter and supervise two-thirds of all commercial banks, including some of our Nation's largest banks. There is no reason to believe that insurance regulators could not experience the same competitive benefits that banking regulators have experienced.

Benefit number 4, optional Federal chartering would provide for a more uniform, consistent and comprehensive regulation of larger and complex insurance firms. Under our proposal, the Federal regulator would have the resources, the expertise necessary to examine, supervise and regulate large and increasingly global insurance firms. Also under our proposal, a federally chartered insurance company or agency that is subject to supervision by a single Federal regulator would be able to comply with the uniform and consistent national regulatory structure.

Now, I will briefly outline ABAI's proposal.

Our optional Federal chartering proposal calls for the appointment of a Federal commissioner to charter and supervise Federal insurance companies and agencies. federally chartered insurance companies would be subject to a comprehensive set of financial regulations, all of which are designed to ensure their safe and sound operation. To protect consumers, federally chartered insurance companies and agencies would be subject to comprehensive, unfair trade practice, patterned after the NAIC's model Act, Federal law would govern the terms and conditions of insurance policies issued by a federally chartered insurance company. The commissioner could not, however, regulate the rates charged for insurance or require policy forms to be preapproved. Our proposal also calls for the creation of a Federal guaranty corporation, patterned after the Federal Deposit Insurance Corporation.

In summary, we believe that ABAI's Federal optional charter would be good for consumers, good for the insurance industry and the State regulatory system. We also believe that the dual banking system offers a reasonable model for optional Federal chartering, and we are pleased to see in a statement released today that the Council of Insurance Agents and Brokers endorses that approach.

Thank you again for the opportunity to appear before this subcommittee.

[The prepared statement of Glen J. Milesko follows:]

PREPARED STATEMENT OF GLEN J. MILESKO ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION INSURANCE ASSOCIATION

Mr. Chairman and members of the Subcommittee. My name is Glen Milesko. I am the Chairman and Chief Executive Officer of Banc One Insurance Group, and I am here today on behalf of the American Bankers Association Insurance Association ("ABAIA").[1] My testimony today also reflects the views of the American Bankers Association.

ABAIA's members are banking organizations engaged in the business of insurance. My own company, for example, was established in 1990 and has one of the country's lead bank-insurance programs. It is comprised of a nationally licensed, full line insurance agency with over 3,000 licensed agents; one credit life and two property and casualty reinsurance companies; one multi-state direct credit life insurance

[1] The American Bankers Association Insurance Association is a separately chartered trade association and non-profit affiliate of the American Bankers Association. ABAIA's mission is to serve as a forum for long-term national strategy among banking organizations on insurance matters, to propose legislation and regulations that permit banking organizations to participate fully in the business of insurance, to protect all existing insurance powers of banking organizations, and to monitor insurance developments at the state level with the support of the nationwide network of state banking associations.

company; a third party administrator of self-funded company health and dental plans; and an international life reinsurance company located in Dublin, Ireland. Banc One Insurance Group represents 5 million policyholders nationwide, generating annual premium sales in excess of $2 billion, claims payments of $75 million and revenues exceeding $500 million.

ABAIA appreciates the opportunity to appear before the Subcommittee as it examines the regulation of insurance and the issue of an optional federal charter for insurance firms.

A little over two years ago, ABAIA developed its own "blueprint" for the federal chartering and regulation of insurance firms. While Congress considered financial modernization legislation, we put that blueprint on the "back burner." Now that financial modernization has been enacted, we have made optional federal chartering a priority for our Association, and we are in the process of transforming our blueprint into a specific legislative proposal.[2]

In the time allotted to me this morning, I will explain why ABAIA supports optional federal chartering for insurers and insurance agencies, and I will outline some of the key features of our proposal.

The Benefits of an Optional Federal Charter

ABAIA supports optional federal chartering for insurers and insurance agencies because, as I will explain, we believe that federal chartering would:

(1) benefit the consumers of insurance by permitting more uniform policies, greater product choice, greater price competition and increased product availability and mobility;
(2) stimulate competition in the insurance industry to the benefit of the industry and the consumers of insurance;
(3) enhance the quality of insurance regulation, while maintaining the integrity of the state insurance regulatory system; and
(4) provide more uniform, consistent and comprehensive regulation for larger insurers and insurance agencies.

Optional federal chartering would benefit many consumers. State regulation of insurance has a long, and commendable, history. However, as our nation's economy has become more national and international, state insurance regulation has been unable to address the needs of consumers who seek new and more uniform products.

Consider the impact of state regulation on insurance policies. Today, each state regulates the terms and conditions of an insurance policy sold within it's borders. With 50 states, it is not surprising that policy requirements vary from state to state. If an insurer sells policies in multiple states, the insurer must either sell different policies to consumers in different states or use a uniform policy that incorporates the requirements of all of the states in which the policy will be sold. This means that policies issued in multiple states are either not uniform or they are overly complex. In today's mobile society, a consumer should be able to receive the same policy regardless of where the consumer resides.

The following demonstrates other examples of how disparate and archaic the current process is for national and Internet insurance sales.

- *Inconsistency in agent licensing.* Each state has varying levels of prelicensing education and different methods and education content for ongoing continuing education. With state regulation there is a need to separately apply in each state using different forms with different requirements to obtain a nonresident license, and a need for each agent to be appointed in each state by every carrier he/she represents.
- *Inconsistency In Collateral Forms and Filing Requirements.* Each state in which sales are made will have different customer collateral forms and filing requirements. If the customer replaces one insurance product with another, for example, each state will have its own form requirement that will vary in content and size, ranging from one page to several pages. If an insurer makes a change to a form, re-filing may be required before it is used. If used on the Internet, filing requirements also will vary with each state.
- *Inconsistency in Sales and Advertising Requirements.* Most states have specific and different rules for each insurance product type and distribution method. Additionally, many states require sales materials and advertising to be filed be-

[2] During the past two years, we have discussed our blueprint in both private meetings and public forums with many interested parties, including major insurance trade associations, representatives of the National Association of Insurance Commissioners, representatives of consumer groups and the staff of this Subcommittee. We have made various revisions to the blueprint based upon those discussions. We plan to continue to engage in a dialogue with any and all interested parties as we work on our draft bill and once it is complete.

fore they are used. Most states are currently unclear on advertising requirements for Internet sales and whether filing of sales materials is required.

Existing state insurance regulations also inhibit the development of new insurance products. Currently, the states review, to varying degrees, the introduction of new insurance products. If an insurer plans to offer a new product in every state, this review process can take months, even years. Such time delays rob consumers of product innovations and product choice. Additionally, e-commerce delivery cannot be encumbered, long-term, through state-by-state differences. Most companies, including other financial services firms, are able to introduce new products to meet the needs of consumers as those needs change.

Under our proposal, a federally chartered insurer or insurance agency that is supervised by a single federal regulator could meet the changing needs of consumers by offering uniform products nationwide and by introducing new products and services without any governmental review.

Optional federal chartering would stimulate competition in the insurance industry to the benefit of both consumers and the insurance industry. A basic tenet of our economy is that free and fair competition builds strong and efficient companies that are responsive to the needs of their customers. Currently, however, some state insurance laws inhibit competition in the insurance industry to the detriment of consumers and the industry. State anti-rebating laws are an example of anti-competitive state laws. Anti-rebating laws prohibit an insurer or insurance agent from rebating premiums to a consumer as an inducement to purchase a policy. Rebates are a legitimate form of price competition that can reduce costs for consumers. Many other industries, such as the automobile industry, use rebates to lower costs for consumers.

State rate laws are another example of anti-competitive state insurance requirements. These laws set the price for certain forms of insurance, such as auto insurance. There is, however, little justification for price controls in an industry in which there is relative ease of entry, such as the insurance industry. New entrants can serve to lower rates that are artificially inflated. Furthermore, the elimination of such price controls can, over time, lower the cost and increase the availability of insurance.[3]

Our optional federal chartering proposal would stimulate competition in the insurance industry to the benefit of consumers and the industry by allowing premium rates to be set by market forces and by permitting federally chartered insurers and agencies to engage in price competition through rebates.

Optional federal chartering would enhance state insurance regulation. Since 1863, commercial banks have been free to choose to be regulated by either a state or the Federal Government. This dual chartering option for banks, commonly referred to as the dual banking system, has resulted in a healthy competition between state and federal banking regulators.

Competition between state and federal banking regulators has stimulated the development of new products and services for consumers. Decisions by federal banking regulators have permitted banks to sell annuities, expand securities and mutual fund activities, and certify the security of Internet transactions. Other innovations, like variable rate mortgages and NOW accounts, which pay interest on transaction balances, first appeared in banks subject to state regulation.

Competition between state and federal banking regulators also has fostered better supervision of banking organizations. Permitting institutions a choice of regulators forces a regulator to update and improve examination techniques and examiner training.

Importantly, the competition between state and federal banking regulators has not resulted in a "race to the bottom" through the relaxation of basic safety and soundness standards, nor has it diminished the role of state regulators. Today, state banking departments charter and supervise approximately two-thirds of all commercial banks, including some of the nation's largest banks, and state-chartered banks hold approximately 42 percent of the nation's total banking assets.

[3] Support for this view can be found in a recent study authored by Scott Harrington for the AEI-Brookings Joint Center for Regulatory Studies. That study, 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.

There is no reason to believe that insurance regulators could not experience the same competitive benefits from optional federal chartering that banking regulators have experienced under the dual banking system.[4]

Optional federal chartering would provide for more uniform, consistent and comprehensive regulation of larger and complex insurance firms. It is a challenge for any single state regulator, especially one with limited resources, to supervise an insurance firm that is active in many different jurisdictions. Under our proposal, the federal insurance regulator would have the resources and expertise necessary to examine, supervise and regulate large, and increasingly global, insurance firms.

Many insurance firms, like my company, are engaged in the business of insurance in every state, and in other countries around the globe. Needless to say, complying with different rules and regulations in more than 50 different jurisdictions is both difficult and costly. Under our proposal, a federally chartered insurer or insurance agency that is subject to supervision by a single federal regulator would be able to comply with a regulatory scheme that is uniformly and consistently applied throughout the United States and abroad.

ABAIA's Proposal

I will now outline the key features of our optional federal chartering proposal. Not surprisingly, the fundamental elements of our proposal are patterned after the dual banking system. Given the banking industry's positive experience with that system, this was a natural choice for us. We realize, however, that there are differences between the business of banking and the business of insurance. For that reason, our proposal melds features of the dual banking system with some features of state insurance law. We also realize that there may be better ways to provide for an optional federal charter for insurance. Nonetheless, we hope that by outlining our proposal—even though it is not in final form—we can further the dialogue on this issue.

Office of the National Insurance Commissioner. Our proposal calls for the creation of a new bureau within the Treasury Department—the Office of the National Insurance Commissioner. The head of this office, the National Insurance Commissioner, would be a Presidential appointee, who would serve a five-year term. The National Insurance Commissioner would have the power to charter, supervise and regulate insurers and insurance agencies. Fees paid by federally chartered insurers and insurance agencies would finance the operations of the Office of the National Insurance Commissioner.

The proposed Office of the National Insurance Commissioner is patterned after two existing Treasury bureaus, the Office of the Comptroller of the Currency, which charters national banks, and the Office of Thrift Supervision, which charters federal thrifts.

An obvious alternative to a new bureau within the Treasury Department (or a new bureau in some other federal department) is the creation of a new independent regulatory authority. We have no objection to this alternative. Our selection of a bureau within the Treasury is based upon our desire to parallel the structure of the dual banking system. It also reflects our belief that a single Commissioner can be a more effective regulator than an agency managed by a commission or a board.

Two New Federal Entities. The National Insurance Commissioner would have the power to charter two new federal entities: "National Insurers," which could underwrite insurance, and "National Agencies," which could broker or sell insurance. National insurers could be organized in either mutual or stock form, and they could be owned by mutual or stock holding companies. Federally chartered insurers could underwrite all forms of insurance. However, like a state insurer, a federally chartered insurer could not underwrite both property and casualty insurance and life insurance within the same company.

The Commissioner could not issue a federal charter to an insurer that did not meet minimum capital requirements or that lacked the management or financial ability to operate in a safe and sound manner. We do not view a federal charter as a means to evade more stringent state regulation, nor do we intend to give federally chartered firms any unfair competitive advantage over state insurers on the basis of solvency regulation.

Financial and Operational Regulations. Federally chartered insurers would be subject to a comprehensive set of financial and operational regulations, all of which

[4] We recognize that the National Association of Insurance Commissioners is engaged in an effort to enhance the quality and responsiveness of state insurance regulation. ABAIA strongly supports that effort. However, we believe that the NAIC's efforts and the creation of an optional federal insurance charter are NOT mutually exclusive and, in fact, very much complement one another.

are designed to ensure their safe and sound operation. These regulations would include: (1) minimum paid-in capital requirements; (2) risk-based capital requirements; (3) reserve requirements equal to actual and estimated claims; and (4) investment limitations.

Additionally, to ensure accountability and transparency of operations, federally chartered insurers would be: (1) subject to generally accepted accounting principles (not regulatory accounting); (2) required to establish a comprehensive system of internal controls; (3) required to create an audit committee composed entirely of outside directors; and (4) required to undergo an annual audit and actuarial analysis by outside auditors and actuaries. Similar requirements were imposed upon banking organizations after the savings and loan crisis.

Consumer Protection. Federally chartered insurers and insurance agencies would be subject to unfair trade practice standards, patterned after the NAIC's model unfair trade practices act. Among other matters, those standards would prohibit: (1) the misrepresentation of benefits; (2) false and misleading advertising; (3) defamation; (4) boycott, coercion and intimidation; (5) false statements; (6) unfair discrimination; and (7) unfair claims practices. Furthermore, the Federal Insurance Commissioner would have the power to adopt other market conduct regulations as needed. Federally chartered insurers and insurance agencies also would be subject to the provisions of the Gramm-Leach-Bliley Act governing the sharing of personal financial information and to a prohibition on the sharing of medical information without the affirmative approval of a customer. State privacy laws would not apply to federally chartered insurers or insurance agencies.

Insurance Policies Issued by a Federally Chartered Insurer. In order to allow federally chartered insurers to issue uniform insurance policies, federal law, not state law, would govern the terms and conditions of insurance policies issued by a federally chartered insurer. The Commissioner would be directed to issue regulations implementing this requirement. The Commissioner could not, however, impose any regulation on the rates charged for insurance or require policy forms to be pre-approved.

We believe that, over time, the elimination of price controls would lower the cost and increase the availability of those forms of insurance that have been subject to rate regulation. To help ensure this result, we would make the federal anti-trust laws applicable to federally chartered insurers. Also, we would require federal insurers to share their rates and policy forms with the Commissioner once they are in use so that consumers could compare prices and policy terms.

Supervision of Federally Chartered Insurers. As a general rule, the Commissioner would be required to conduct annual, on-site examinations of each federally chartered insurer. An exception to this general rule would apply to insurers that are adequately capitalized and fully reserved. They would be subject to a bi-annual examination cycle. Another exception would be for the largest, most complex insurers, which would have examiners located on-site on a permanent basis. Failure to cooperate with an examination would subject an insurer to civil money penalties.

The Commissioner also would have the authority to take an enforcement action against any federally chartered insurer or insurance agency that violated applicable federal law or regulations. These actions would include cease and desist penalties and civil money penalties patterned after those applicable to banking institutions.

National Guaranty Corporation. Our proposal calls for the creation of a federal guaranty corporation, the National Insurance Guaranty Corporation, to guarantee insurance policies issued by federally chartered insurers.[5] The Corporation would be patterned after the Federal Deposit Insurance Corporation ("FDIC"). A five-person board of directors would govern the Corporation. The board would include the Federal Insurance Commissioner, the Chairperson of the Securities and Exchange Commission, the Chairperson of the FDIC and two individuals appointed by the President, one of who would be the Chairperson of the Corporation. The Corporation would establish two separate funds, one for life and health policies and another for property and casualty policies. The type of policies covered by these funds and the scope of coverage would be patterned after NAIC model laws.

Insurers whose policies are protected by the Corporation would be subject to semi-annual, risk-based assessments. Until such time as those assessments would cover the operations and potential liabilities of the Corporation, the Corporation would rely upon a line of credit from the Treasury Department to cover its operations and liabilities.

[5] The current version of our proposal also would permit a state insurer to apply for membership in the Corporation. State insurers that did so would be subject to a limited oversight by the Corporation.

The proposal would limit exposure to losses by empowering the Corporation to take corrective actions against insurers that fail to meet applicable capital and reserve requirements. These corrective actions escalate in severity as an insurer's condition deteriorates. Ultimately, they require the Corporation to place an insurer into receivership or conservatorship before it exhausts its capital and reserves. This "taxpayer protection" provision is based upon powers given to the federal banking regulators after the savings and loan crisis.

We recognize that the creation of a federal guaranty corporation may be one of the more controversial features of our proposal. However, we believe that pre-funded guaranty funds patterned after the deposit insurance funds would provide the best protection for the consumers of insurance. Also, a federal corporation is consistent with our desire to have two independent, and complementary insurance regulatory systems.

Taxation. Finally, our proposal would not alter state tax laws, including state premium taxes.

Conclusion

In conclusion, ABAIA believes that an optional federal charter would be good for consumers, the insurance industry and the state regulatory system. We also believe that the dual banking system offers a reasonable model for optional federal chartering.

Thank you again for the opportunity to appear before the Subcommittee.

Mr. OXLEY. Thank you, Mr. Milesko.

Mr. Smith.

STATEMENT OF RONALD A. SMITH

Mr. SMITH. Thank you, Mr. Chairman, committee members. I am Ron Smith. I am an insurance agent from a small town in Indiana. I am here on behalf of the Independent Insurance Agents of America. We represent some 300,000 agents and employees across the country. We are the oldest and largest agent association in America. Much has been said by the panelists to date, and I will try and be brief in my comments, but I would like to touch on a few things specifically.

We all admit that we do have a changing market. There is no question about that, but we have long been supporters of State regulation and we continue to have that position. As I say, that I do believe that we have to fix some of what State regulation is all about right now, and I think the commissioners have started down that path. Their statement of intent has really made a difference, and they have been moving much more rapidly than they have in the past. I think Congress has helped make sure that that has happened.

I would like to specifically talk about four things that are particularly important to us: agent producer licensing privacy, product regulation and consumer protections.

First, in the agent producer licensing arena, as a small agent in a small town, I would tell you that I operate and have licenses in 16 States. The current licensing model is rather inefficient, time consuming and frustrating to me as a particular producer. I would tell you that a model licensing bill, model licensing law that the insurance commissioners have been working on is one that our association supports. We have had discussions as late as Friday with some revisions that we think need to take place in that model law. We will probably have some more discussions in the next week or 2. If we can get that model law, I think we will have 50 State associations working very hard to clear a lot of the log jams in our current licensing process. It is, trust me, a time-consuming and expensive endeavor for an agency like ours.

No. 2, privacy. Privacy, we believe, is something that is extremely important. For years, we have protected the privacy of our clients. As the financial services industry is evolving, I believe that we as agents also have to disclose more and more things to our clients. Our belief is that we make—we have to make sure that there is a level playing field. All people providing financial services must meet the same privacy standards and must be guided by the same set of standards or we will have confusion across the States.

Part of regulation. Our Association is on record as being in favor of commercial lines, rate deregulation. We believe that the marketplace can indeed determine rate regulation as long as we have and continue to maintain a competitive market. We think the NAIC can oversee that procedure and we believe that we can enact some of the pieces that will let companies bring products to market quicker. We believe that, indeed, is an essential piece as we move forward in the process of getting product to our consumers.

And last but not least, consumer protections. Through all of what we are doing, we as agents have been very mindful of consumer protections and how important they are. We think the proper place to enforce consumer protections for insurance industry is with the NAIC. We think the various commissioners know their constituents on a broad basis and know exactly what they want and what they demand, and we believe that the NAIC is the place to have that continue to take place.

We see the financial services arena as changing very rapidly. We as an association, as a group of agents, are committed to working with the NAIC to pushing them into furthering their efforts, their speed to market, their various statements of intent that they have made. I would tell you as a personal note, as an agent, I have now been attending the NAIC meetings over the course of the last 3 years. There is a sense of urgency at the NAIC that has not been demonstrated before. I believe they understand the pressures that they are under. I believe that they are implementing the framework that they need to move forward into the 21st century and to continue to regulate insurance properly. Thank you very much.

[The prepared statement of Ronald A. Smith follows:]

PREPARED STATEMENT OF RONALD A. SMITH, PRESIDENT, SMITH, SAWYER & SMITH, INC.

Good morning. My name is Ron Smith. I am President of Smith, Sawyer & Smith, Inc., an insurance agency located in Rochester, Indiana. I am the current State Government Affairs Chairman and a Past President of the Independent Insurance Agents of America, the country's oldest and largest national association of insurance producers, representing more than 300,000 independent insurance agents and employees. IIAA's membership is composed of large and small businesses that offer consumers a wide array of products, ranging from property, casualty, life, and health insurance to employee benefit plans and retirement programs.

I appreciate the opportunity to testify this morning on a topic of great interest and critical importance to independent insurance agents—the future of insurance regulation.

I. INTRODUCTION

I should note at the outset that we have been ardent supporters of state regulation of insurance throughout our more than 100-year existence. Our national board of directors has repeatedly affirmed our support for state regulation—for all participants and all activities in the marketplace.

For 200 years, states have successfully accepted and performed the role of insurance regulation, nearly uninterrupted. When a 1944 Supreme Court decision produced uncertainty about the scope and preeminence of state regulation, Congress swiftly reacted by passing the McCarran-Ferguson Act the following year. That act "restore[d] the supremacy of the States in the realm of insurance regulation" and its statement of federal policy could not be more clear: "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business."

We do not believe there is sufficient justification for abandoning this traditional policy approach. The states have a historical expertise in the realm of insurance regulation, and there is an absence of any such expertise at the federal level. State regulators have been the virtually exclusive protectors of such interests since the creation of an insurance industry in this country. We hope to ensure that their authority and expertise in the regulation of the business of insurance is not overturned or undermined, even as other industries become more heavily involved in providing insurance services.

Despite our longstanding support for state regulation, we recognize that the current regulatory system does not always operate as efficiently as it should. Agents, like other industry players, sometimes become frustrated with state regulation, and there are certainly areas where the existing system can be enhanced, streamlined, and made more uniform across state lines. Changes in the marketplace in recent years, combined with advances in technology and a new set of emerging realities, make such improvements necessary, and we are committed to working with policymakers and our colleagues on these issues.

While it may not always be perfect, the current system is working. The entire body of state insurance law—statutes and regulations—is frequently revised and updated to address evolving issues and to ensure comprehensive consumer protection. Preservation of the applicability of these state regulations is essential because no comparable regulations exist at the federal level and no federal regulator has expertise in this arena. By their regulation, the states ensure that those who engage in the business of insurance are qualified to do so, remain appropriately qualified, offer sound insurance products, and comply with reasonable safeguards for the protection of consumers. Given the important role that insurance plays in our lives, this is essential.

Over the last several months, the National Association of Insurance Commissioners (NAIC) has aggressively considered and debated how the current regulatory regime might be modified and improved. This effort began with the adoption of the "Statement of Intent," a document which outlines a framework of principles through which the country's insurance regulators have begun to address the challenges and opportunities confronting state regulation. The statement is essentially a blueprint of issue-specific goals that the NAIC intends to tackle in the immediate future. These objectives relate to issues that must be addressed quickly, such as the implementation of the Gramm-Leach-Bliley Act (GLBA), and those issues that will take longer to resolve, such as the state response to globalization, the emergence of technology, and the call for reform of the current regulatory system.

II. AGENT AND PRODUCER LICENSING

One area of insurance regulation that has drawn warranted criticism is the manner is which states license insurance agents. Our agent and broker members increasingly operate in multiple states and obtain growing numbers of nonresident licenses, and they struggle to stay on top of the required paperwork and clear the logistical and bureaucratic hurdles that are in place today. Staying in compliance with the distinct and often idiosyncratic agent licensing laws of every state is no easy task. It is an expensive, time-consuming, and maddening effort for many agencies, and a dedicated staff person and tremendous financial resources are often required to manage an agency's compliance efforts. These opportunity costs and wasted man-hours could be better spent working on behalf of our customers. Many of our members are frustrated because they are trapped in a licensing system full of antiquated, duplicative, unnecessary, and protectionist requirements. Adding to the frustration is the fact that these inefficiencies exist at a time when advances in technology have encouraged society to expect ease, efficiency, and speed—even from government agencies and state insurance departments.

The problems associated with the current system can be divided into three main categories: (1) the disparate treatment that nonresidents receive in some states; (2) the lack of standardization, reciprocity, and uniformity; and (3) the bureaucracy generally associated with agent licensing. The NARAB provisions contained in the Gramm-Leach-Bliley Act ensure that these three problem areas will be addressed soon—either by the automatic implementation of the provisions themselves or by the enactment of preemptory reforms at the state level.

Elements Required to Forestall NARAB's Creation

The "NARAB provisions" contained in Subtitle C of Title III of the Gramm-Leach-Bliley Act offer the promise that effective licensing reform may finally be imminent. NARAB, the National Association of Registered Agents and Brokers, is an entity that does not exist today but is one that would be created if the states cannot on their own reach the licensing reform goals outlined by Congress. In essence, the NARAB provisions put the ball in the states' court. The new licensing agency will only be established if the states fail to take the steps necessary to forestall its creation. In this way, the threat of NARAB creates a strong incentive for the states to reinvent and streamline the current multi-state licensing process.

The GLBA is clear about what it is required to prevent the establishment of NARAB. The creation of the new "agency" will only be averted if a majority of states (defined by virtue of the statute as 29 states or territories) do not achieve the specified level of licensing reciprocity or uniformity. The Act is specific about the reforms that are necessary, and it gives the states two options—licensing uniformity or licensing reciprocity.

Reciprocity is the easier test to satisfy, and it is the initial goal of state policymakers. To achieve reciprocity, the Gramm-Leach-Bliley Act requires that a majority of states license nonresident agents and permit them to operate to the same extent and with the same authority with which they operate and function in the resident state. This sounds simple, but every state will need to make statutory and regulatory changes in order to meet the level of reciprocity required. The reciprocity standard in the NARAB provisions essentially requires each qualifying state to meet a 3-part test:

- *First,* states may not impose any unique licensure requirements on nonresidents and may only require a nonresident to submit (1) a license request; (2) proof of licensure and good standing in the home state; (3) the appropriate fees; and (4) an application.
- *Second,* states must offer continuing education reciprocity to any person who satisfies his/her home state requirement.
- *Third,* states must not "impose any requirement . . . that has the effect of limiting or conditioning [a] producer's activities because of its residence or place of operations," excluding countersignature requirements.

In short, to satisfy the NARAB test, states must offer full reciprocity to nonresident agents—without imposing any additional obligations or requirements. In order to be "NARAB-compliant," a state must be willing to accept the licensing process of a producer's home state as adequate and complete. No additional paperwork or requirements may be required—no matter how trivial or important they may seem.

The states collectively have three years to achieve the required level of reciprocity. If 29 states fail to offer reciprocity to nonresidents by November 12, 2002, the NAIC will begin the process of establishing NARAB, as provided by the statute. The law requires that the new entity begin operation within two years of the initial deadline. It is unlikely, however, that NARAB will ever come into existence. IIAA believes the states will meet the level of reform required by Congress and create a licensing system that is in fact superior to that offered by the NARAB provisions.

Recent Reform Activity / NAIC Producer Licensing Model Act

Even before the passage of the Gramm-Leach-Bliley Act, efforts were underway to reform and streamline the existing licensing system, and some significant strides had already been made. The NAIC, for example, had developed a national application form for agents, established the Uniform Treatment Initiative (an initial step toward reciprocity), and developed groundbreaking regulatory tools such as the Producer Database and Producer Information Network. In addition, many states have recently taken action to eliminate longstanding discriminatory barriers, such as countersignature laws, residency requirements, and solicitation restrictions. The focus on agent licensing reform, however, has clearly intensified since the enactment of the GLBA.

The most critical response has been the development of the "Producer Licensing Model Act," a model law adopted by the NAIC. The hope is that every state legislature will consider and adopt the proposal, thus providing much needed uniformity to the current licensing system. We believe the Producer Licensing Model Act will be the starting point for agent licensing reform in every state, and we commend the NAIC for the hard work and dedication associated with its development.

The model was initially adopted in January, and revisions to the existing product will be considered by the NAIC in early October. The adoption of the amended model in the coming weeks will be the culmination of more than two years worth of effort by state policymakers and many in the private sector. We are particularly proud of the pivotal role that IIAA played in the development of the proposal. Early in the process, we assumed a leadership role by bringing together all of the various private sector groups to discuss many of the issues that had divided the insurance industry. Our efforts to broker consensus were successful in a number of key areas and helped enable the NAIC to proceed quickly with its consideration of the model.

The proposed revisions to the model are significant and will lead to the adoption of the model in the states. As this subcommittee knows, IIAA and its membership had some concern with the original version of the model. One ambiguously worded licensing exemption would have created a loophole that would have allowed unlicensed and unqualified individuals to offer advice and guidance, discuss policy options with unknowledgeable consumers, and materially revise existing policies and insurance contracts. IIAA encouraged the NAIC to delete the unnecessary exemption, and the NAIC's NARAB Working Group, the committee with jurisdiction in this area, recommended on Friday that the provision be deleted altogether. To its credit, the NAIC has now taken steps to eliminate the potential for conflicting interpretations, avoid the need for judicial interference, and most importantly, protect insurance consumers.

The NAIC Producer Licensing Model Act addresses a wide range of issues and will result in unprecedented uniformity among the states. Among other items, the model includes the following:

- A requirement that any person "selling," "soliciting," or "negotiating" insurance be licensed and a prohibition against unlicensed individuals performing these same functions without a license—regardless of the context;
- Definitions of the major lines of insurance;
- The recognition of a uniform process for obtaining a resident license;
- The creation of a common set of requirements for obtaining nonresident licenses;
- The recognition and acceptance of a common national application—for both residents and nonresidents;
- Uniform standards for agent/insurer appointments;
- The establishment of true licensing reciprocity; and
- The elimination of discriminatory licensing requirements.

The NAIC model will bring uniformity to the licensing process in many ways that are not required under the NARAB provisions of the Gramm-Leach-Bliley Act. The bill does, however, contain the provisions necessary for a state to become "NARAB-compliant" by establishing the requisite level of reciprocity.

While the model law offers many important benefits, the NARAB deadline is still the focus of significant attention. States will have no more than two legislative sessions to address this issue, so timing is certainly critical. Despite the challenge, we are committed to working with the states to achieve agent licensing reform and forestall the creation of NARAB by the November 2002 deadline. In fact, our members and state organizations are already working closely with state departments of insurance and the industry to lay the groundwork for legislative action in 2001. We believe many states will take action on this issue beginning in January, and we are optimistic that the NARAB threshold of 29 states may even be cleared by the end of 2001—nearly one year ahead of the timeframe established in the GLBA.

NAIC President George Nichols, NARAB Working Group Chair Terri Vaughan, and the leadership of the NAIC have made it clear, however, that they will not settle for uniformity and reciprocity in 29 states alone. While clearing that 29-state hurdle is all that is required under the GLBA, the insurance regulators are pushing for "national" reform. We wholeheartedly support the notion that effective reform must be national in scope and commend them for their hard work in this regard. The NAIC has made it clear that simply reaching the bare minimum required by federal law is not enough, and their words have been supported with actions and leadership.

National Insurance Producer Registry

The NAIC's vision for reinventing agent licensing—a vision that we share—does not end with the ultimate state adoption of the Producer Licensing Model Act. The licensing process will be further revolutionized by the work and continued development of the National Insurance Producer Registry (NIPR), a non-profit affiliate of the NAIC. NIPR is the private-public partnership directed by a nine-member Board of Directors. The Board is composed of four regulators, a NAIC representative, three insurer representatives, and one agent/broker representative.

Today, NIPR is responsible for developing and maintaining the Producer Database (PDB) and the Producer Information Network (PIN).[1] Once the necessary statutory changes are implemented at the state level, NIPR will utilize technology and its existing services to create a simpler and cost-effective licensing environment for agents. NIPR recently unveiled a detailed plan that will ultimately lead to the development of a system through which agents will obtain nonresident licenses in multiple states by using a single on-line point of entry. In the near future, a person licensed and in good standing in their home state will have the ability to obtain licenses in other states by submitting a single license application to NIPR, along with the payment of both state and NIPR fees. Upon receipt, NIPR will perform an automated verification to ensure that the producer holds an active resident license and will then issue, at the direction and on behalf of the state(s), the appropriate nonresident licenses.

IIAA currently sits on NIPR's Board of Directors, representing the interests of the producer community with regard to these important initiatives, and we are very encouraged by the progress that the NAIC and NIPR have made to date. Given the importance of NIPR's mission to the agent and broker community, we have proposed that the makeup of the Board be reconsidered. Specifically, we have proposed adding two new producer representatives to the board (thus establishing parity between the insurer and producer communities) and adding two additional regulator representatives (thus preserving the balance between the private and public sectors). While we commend NIPR for opening its meetings to an expanded audience, we believe the reconstitution of the Board is critical. The decisions of the Board directly impact the agent and broker community, and we believe that perspective should have an equal voice in the development of NIPR policies and services.

Regulator and Industry Access to the NCIC Database

An area in which significant reciprocity is lacking is the manner in which states investigate the criminal histories of potential license holders and verify the information submitted on license applications. States today have a variety of different requirements and processes for doing this. Some states simply ask an applicant whether they have a criminal history or if they have committed some act that would preclude them from licensure. Other states require applicants to submit a criminal background report with their application. There are also those states that take a proactive role in this process and may even require applicants to submit fingerprint cards so that an individual's record can be checked thoroughly. Whatever the actual process, states typically impose their own individualized background check requirements on nonresident applicants—regardless of whether the applicant's criminal background has already been reviewed by any other state.

There is concern that the wide disparity in requirements and trust among the states in this area could undermine the effort to achieve licensing reciprocity. A state with strong background check requirements is naturally uncomfortable licensing an individual who has not previously gone through the same rigors and background review that the state would otherwise require. However, under the NARAB provisions, a state could arguably have to license such an individual.

One possible solution is to centralize this function, develop a common process, and require only one background check for every producer, which could be updated on a periodic basis and/or whenever a new nonresident license is sought. This could perhaps be facilitated by providing NIPR with limited and clearly defined access to the National Crime Information Center (NCIC) database. Similar processes exist in other contexts, and we believe it is a model worth considering. The NAIC has asked Congress to authorize NCIC access, and we continue to support this concept.

Given the sensitivity of the information contained in the NCIC database, however, any grant of access must be thoughtfully considered and properly constructed. This issue raises serious privacy concerns, and the proper balance must be obtained. IIAA, in conjunction with other insurance industry associations, has already developed a proposal that would provide insurance regulators with access to the database so regulators can effectively and proactively perform their licensing responsibilities. The proposal would also provide limited access for employers who wish to perform personnel checks on employees or potential employees. In our view, there is no pub-

[1] PDB is an electronic database consisting of information about producers and includes information about a producer's licensing status, appointment history, and disciplinary actions. PIN is an electronic communications network that links state insurance regulators with the entities they regulate in order to facilitate the electronic exchange of producer-related information.

lic policy justification for providing unlimited and unqualified access to these files to anyone that might request them.

III. PRIVACY

State policymakers are also taking action to satisfy the Gramm-Leach-Bliley Act's Title V privacy requirements. There is perhaps no more important topic in politics today than ensuring that the private information of individuals remains just that—private.

This is also an area where uniformity of regulation and enforcement is critical. Privacy regulations and requirements should be uniform both among the states and with the requirements that will be imposed on banks and other financial services providers by the federal banking agencies, the Securities and Exchange Commission and the Federal Trade Commission. This uniformity is essential to ensuring that the "level-playing field" aspirations of the GLBA are fully realized. If the obligations are not uniform, then consumer protection will be undermined and competition among financial services providers will be negatively affected—likely to the detriment of state-regulated insurance providers. It also is necessary to ensure that insurance agents that also are subject to the jurisdiction of a federal regulator—such as a life insurance agent that also is a registered securities broker—are not subject to conflicting or inconsistent privacy obligations.

In order to provide national uniformity in the regulation of consumer privacy, the NAIC is developing a model regulation. This model, which is intended to be promulgated as a regulation by state insurance departments, addresses the privacy of financial information (as required by Title V of the GLBA) and the privacy of health or medical information. We are fairly satisfied by the approach the NAIC has taken on the financial side, and we believe the model regulation is consistent with the federal regulations. We have some concerns with the structure of the health information piece and continue to vet the latest draft with our members. We have been pleased, however, by the NAIC's willingness to discuss and debate the scope and nature of its proposal.

IV. PRODUCT REGULATION

The NAIC's reform agenda also calls for a review of how states regulate the development of insurance products and their introduction into the marketplace. As part of the "Speed to Market" initiative, the NAIC is considering the manner in which states regulate policy forms and rates and is identifying ways to improve the multistate system. IIAA recognizes that the NAIC is tackling this issue even though not compelled to do so by any federal mandate, and we commend the organization for making this a priority.

Today, while each state's particular approval mechanism may differ, rates and policy forms are subject to some form of regulatory review in nearly every state. While most insurance codes provide that rates shall not be inadequate, excessive, or unfairly discriminatory and that policy forms must comply with state laws, promote fairness, and be in the public interest, there are a variety of ways in which states currently regulate rates and forms. These systems include prior approval, flex rating, file and use, use and file, competitive rating, and self-certification. The manner in which rates and forms are approved and otherwise regulated can differ dramatically from state to state and from one line to the next. These requirements are important 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 is too often inefficient, paper intensive, time-consuming, arbitrary, and inconsistent with the advance of technology and the regulatory reforms made in other industries. Many argue that regulation of insurance and the cost of regulation exceeds what is necessary to protect the public, particularly in the area of commercial insurance. It is hard to disagree with the call for rate and form modernization when considering that it often takes two years or more to obtain regulatory approval to bring new products to market on a national basis. Cumbersome inefficiencies can create lost opportunity costs, and the regulatory regime in many states is likely responsible for driving many consumers into alternative market mechanisms.

IIAA is optimistic that the NAIC's Speed to Market initiative will lead states to review and revise their laws to ensure that new products, coverages, forms, and plans can enter the marketplace in an efficient, timely, and responsive manner. We are strong believers in a free and competitive market, and we support efforts to enhance competition and product innovation. We must be careful, however, to strike a proper balance between free enterprise innovation and consumer protection and not take actions that place consumers at risk. Improvements can be made in the area of product regulation, but this effort should not result in an abdication of regulatory oversight. Instead, we hope this modernization effort will bring about enhancements to the review process, allow the industry to introduce products more efficiently, and permit insurers and agents to be more responsive to the needs of the public.

As part of its Speed to Market initiative, the NAIC recently unveiled a proposal to create the Coordinated Advertising, Rate, and Form Review Authority (CARFRA). The plan to establish this new organization was only recently released, and there are many issues and questions that must still be addressed. The NAIC is now moving quickly to consider the details of this new concept, and it may be that CARFRA offers a viable mechanism for coordinating and standardizing the rate and form approval process. In addition to creating the CARFRA proposal, the NAIC has established a subgroup to develop a series of recommendations aimed at further improving state-based filing and review procedures. This subgroup is composed of five regulators, two insurer representatives, two consumer advocates, and an agent/broker representative. We are pleased to sit on this committee and believe it is an excellent way to facilitate dialogue among the parties affected by product regulation.

V. CONSUMER PROTECTIONS

Perhaps most importantly, the NAIC's modernization agenda does not forget about consumers. In fact, consumer protection is the leading principle and highest priority guiding the NAIC's activities. The NAIC's Statement of Intent begins by saying: "Our primary goal is to protect insurance consumers, which we must do proactively and aggressively." Although the NAIC has established a new Consumer Protections Working Group dedicated to discussing specific statutory protections and promoting the adoption of safeguards in the states, the emphasis on consumer protection affects all of the NAIC's efforts.

Unfortunately, the NAIC's focus on consumer protection has been challenged and undermined in recent months. In three separate instances, the Office of the Comptroller of the Currency (OCC) has been asked by banking industry groups to toss aside state level insurance sales consumer protections. Specifically, these groups have asked the OCC to preempt consumer protections previously enacted in Massachusetts, Rhode Island, and West Virginia.

An ill-advised OCC preemption opinion issued in response to these requests could disrupt regulatory activities in the more than 30 states that have substantively identical insurance sales protection provisions in place. This is especially troubling because—virtually without exception—these consumer protections were enacted with the support of consumer advocates as well as both the banking and insurance industries in each state.

The West Virginia experience is illustrative of this concerning trend. There, the local banking association that petitioned the OCC actively negotiated the parameters of the law that they have asked to be preempted, and they endorsed enactment of that legislation. Over two dozen banks are actively selling non-credit forms of insurance in the State of West Virginia and their efforts do not appear to be hampered in any way by the challenged provisions. Any allegation that the West Virginia provisions at issue should be preempted because those provisions "prevent or significantly interfere with" the ability of banks to engage in insurance agency activities thus appears to be completely unwarranted.

A large and diverse group of parties wrote to the OCC during two public comment periods to question the agency's authority to consider these questions and to encourage the agency to preserve the challenged protections. This group included the NAIC; the National Conference of Insurance Legislators (NCOIL); the National Conference of State Legislatures (NCSL); members of Congress; individual state legislators, attorneys general, and insurance commissioners; and consumer advocates (including the Consumer Federation of America).

We have urged the OCC to not deem any of the challenged consumer protection requirements preempted for two overarching reasons. First, it is clear the OCC does not have the power to determine whether state insurance regulations are preempted by Section 104 or by any other federal law. The GLBA makes clear that the states are empowered to regulate the insurance activities of everyone, including national banks. The only limitation on that authority is Section 104, but the OCC has absolutely no authority to interpret the parameters of that provision. Second, even if the Comptroller did have the authority to pass on such preemption questions, it is clear that state insurance sales consumer protection provisions like the challenged requirements do not "significantly interfere" with the ability of banks and bank-affiliates to engage in insurance agency activities in any way. The challenged provisions were enacted to address serious insurance consumer concerns, and none violate the preemption standards established in Section 104.

The manner in which the OCC proceeds will have a dramatic effect on the future of insurance regulation. We are concerned because we believe that preemption of these state laws by the OCC would undermine the functional regulation framework that is at the core of the Gramm-Leach-Bliley Act.

VI. CONCLUSION

By enacting the Gramm-Leach-Bliley Act, Congress in some ways threw down the gauntlet to state policymakers. In the 10 months since the law's historic passage, state insurance regulators have proven that they are up to the challenges at hand. Not only are they fulfilling the obligations created by the GLBA, they are also reforming insurance regulation in other crucial ways. State legislators are also proving that they are prepared to modernize and enhance state regulation of insurance, and legislative groups such as NCOIL and NCSL are engaged in these discussions and working closely with the NAIC. In the weeks and months to come, we will continue to work closely with the NAIC, state legislators, our member agents, and other interested parties to achieve meaningful reform on a national basis.

IIAA appreciates the opportunity to comment and present our views on the state and future of insurance producer licensing. As you continue to consider these issues, please know that we are happy to provide any further assistance or information that this subcommittee might deem appropriate and helpful.

Mr. OXLEY. Thank you, Mr. Smith.

Mr. Hillman.

STATEMENT OF RICHARD J. HILLMAN

Mr. HILLMAN. Mr. Chairman and members of the subcommittee, I am pleased to be here today to discuss with you our report on insurance regulation that is being released today. This report requested by Congressman Dingell presents our evaluation of insurance regulatory oversight and information sharing triggered by a highly publicized insurance investment scam allegedly masterminded by Martin Frankel. My testimony today focuses on three issues.

First, I will briefly describe how the alleged investment scam operated. Second, I will describe some of the information sharing and regulatory weaknesses exposed by the scam. Finally, I will discuss the crucial importance of enhancing regulatory information sharing going forward in the new era under Gramm-Leach-Bliley.

Martin Frankel is under indictment for allegedly embezzling more than $200 million in insurance company assets over nearly an 8-year period. Mr. Frankel, a former securities broker who was banned from that industry in 1992, with assistance from others, allegedly obtained secret control of entities in both the insurance and securities industries. In 1991, he allegedly exercised secret control over a small securities firm called Liberty National Securities. The same year, he allegedly anonymously established an entity known as Thunor Trust using the names of nominee grantors as the apparent sources of the money.

Between 1991 and 1999, Mr. Frankel operating through fronts, allegedly used Thunor Trust to purchase seven insurance companies in six States. After purchasing these companies, the companies' assets were sold and apparently replaced with government bonds purchased on the insurer's behalf by Liberty National Securities. These securities firms then allegedly provided monthly statements to each insurance company detailing an active and profitable bond trading strategy that were, in fact, fabrications.

It appears that the securities transactions never happened as reported, and Federal authorities allege that Mr. Frankel actually stole the insurers assets and used the funds to perpetrate the investment scam and support his lavish lifestyle. After operating for nearly 8 years, the scam began to unravel as insurance regulators placed more scrutiny on the insurers asset custody arrangements. Federal and State authorities now have criminal and civil cases pending against Frankel, and others allegedly connected to the scam. Mr. Frankel, while being held by German authorities and facing extradition to the United States, has not yet been convicted for any of the actions that are attributed to him. As yet, the whole story has not been told.

Weaknesses associated with insurance regulatory tools and inadequate oversight and coordination activities contributed to delays in detecting the investment scam for years. We observed regulatory weaknesses in each of three key phases of regulatory oversight, namely, approval and change on insurance company ownership, routine financial analysis and onsite examinations. Table 1, in my prepared statement today, summarizes the weaknesses we identified in each of the phases of regulatory oversight.

In some cases, the identified weaknesses involved a lack of the appropriate policies and procedures for identifying problems in the Thunor Trust insurers. At other times, State insurance regulators failed to follow existing policies procedures or recommended practices. Overall, however, regulators did not act in response to red flags raised by the actions of Thunor Trust, insurance companies or Liberty National Securities. These red flags did not necessarily rise to the level of illegality but individually, and certainly collectively, they should have led regulators to ask more and harder questions, the answers to which very likely would have uncovered the scam much sooner.

We believe that all financial regulators, including State insurance regulators, have a positive responsibility to act with professional skepticism. It is clear that for many years in this case, insurance regulators did not.

I was pleased to find that the insurance regulators working with NAIC have recognized the weaknesses we have identified, and while much more needs to be done, they have begun addressing them to help reduce the industry's vulnerability to fraud.

The final topic I want to briefly mention is the importance of regulatory information, sharing particularly in the area of Gramm-Leach-Bliley. At nearly every stage of the scam I describe d for you today, regulators could have exposed the fraud sooner and limited the damage if there had been better and more consistent sharing of regulatory information. Insurance regulators will need to apply the lessons learned from this scandal and effectively share regulatory data between themselves and their banking and securities counterparts.

Going forward, all financial regulators will need to consider regulatory data from other financial vectors to properly oversee the business relationships and transactions between institutions in different financial sectors. While it is too early to fully assess regulatory oversight coordination efforts emanating from Gramm-Leach-Bliley, I am pleased to report that there are signs that Federal and State regulators recognized the need to improve coordination and are taking the first steps to formalize coordination mechanisms.

Mr. Chairman, this concludes my statement and I would be pleased to respond to any questions that you or the members may have.

[The prepared statement of Richard J. Hillman follows:]

United States General Accounting Office

GAO

Testimony

Before the House Subcommittee on Finance and Hazardous Materials, Committee on Commerce

For Release on Delivery
Expected at
10:00 a.m., EDT
on Tuesday,
September 19, 2000

INSURANCE REGULATION

Scandal Highlights Need for States to Strengthen Regulatory Oversight

Statement of Richard J. Hillman, Associate Director
Financial Institutions and Market Issues
General Government Division

G A O
Accountability * Integrity * Reliability

GAO/T-GGD-00-209

Summary

Scandal Highlights Need for States to Strengthen Regulatory Oversight

Martin Frankel, a banned securities broker who allegedly migrated from that industry to the insurance industry is under indictment for embezzling more than $200 million in insurance company assets over a nearly 8-year period. Mr. Frankel has not yet been convicted in the United States and others are currently under investigation for assisting him.

This statement focuses on three issues: (1) how the scam happened, (2) the regulatory weaknesses exposed by this scam, and (3) the crucial importance of regulatory information sharing.

What happened? Throughout the 1990s, Martin Frankel, with assistance from others, allegedly obtained secret control of entities in both the insurance and securities industries. He is accused of secretly purchasing 7 insurance companies in several states. Using a securities firm as a front, Mr. Frankel then allegedly took custody of insurance company assets and provided false documents on investment activity to disguise his actual purpose. Instead of managing these assets in a prudent manner, he allegedly diverted them to other accounts he controlled and used them to support the ongoing scam and his lifestyle.

What are the regulatory weaknesses? We observed regulatory weaknesses in multiple states over several years during key phases of insurance regulatory oversight. Specifically, we observed inadequate measures for assessing the appropriateness of buyers of insurance companies, analyzing securities investments, evaluating the appropriateness of asset custodians, verifying the insurers' assets, and sharing information within and outside the insurance industry. We also found some weaknesses in support services provided by the National Association of Insurance Commissioners (NAIC).

What improvements in the sharing of regulatory information are needed? Information sharing failures existed between state insurance departments and other state and federal regulators, including state securities departments, as well as among state insurance department in different states. As highlighted in the Gramm-Leach-Bliley Act, the importance of regulatory information sharing is greater than ever before. The fraudulent activities allegedly perpetrated by Mr. Frankel further demonstrate the need for heightened coordination of oversight activities among regulators in cases where affiliated entities exist.

The insurance industry has recognized its weaknesses and has proposed corrective actions. This statement also contains a number of GAO recommendations, which regulatory agencies generally endorsed.

Statement

Scandal Highlights Need for States to Strengthen Regulatory Oversight

Mr. Chairman and Members of the Subcommittee

We are pleased to be here to discuss with you our report on insurance regulation that is being released today.[1] My testimony today focuses on three issues. First, how did the scam allegedly used by Martin Frankel to steal over $200 million from several insurance companies across the country operate? Second, what are some of the regulatory weaknesses exposed by the scam? These regulatory weaknesses allowed Mr. Frankel to gain control of seven insurers domiciled or chartered in six different states, and delayed detection of the alleged theft for as much as 8 years—greatly increasing the size of the loss. Finally, we will talk about the crucial importance of regulatory information sharing—both in the context of the failure to uncover the Frankel scam and in the broader context of a world with affiliations of financial firms across industry boundaries as permitted by Gramm-Leach-Bliley.

I should note that Mr. Frankel, while currently being held by German authorities and facing extradition to the United States, has not yet been convicted in the U.S. for any of the actions that are attributed to him. At present, these actions are alleged to have been committed by him. Similarly, Mr. Frankel acted with assistance from others. A few of his associates have admitted to roles in Mr. Frankel's alleged scam, and others are under investigation. As yet, the whole story has not been told.

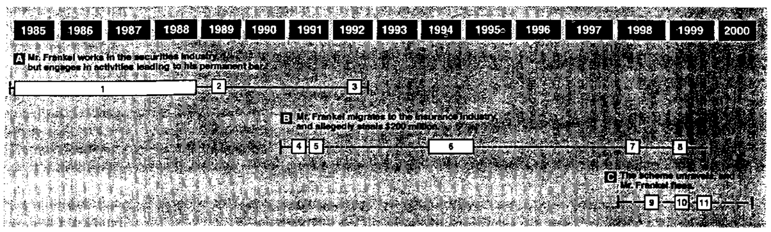
The Scam

In the 1980s Martin Frankel worked in the securities industry. He was permanently banned from the securities industry by SEC in 1992. Even prior to his removal from the securities industry, he was setting up the mechanism to move into the insurance industry. He allegedly gained secret control of a small securities firm called Liberty National Securities (LNS), which in 1991, a year before his ban from the securities industry, he directed to become registered with the state securities department in Tennessee. The same year, he allegedly anonymously established an entity known as Thunor Trust, using the names of nominee grantors as the apparent source of the money. Thunor Trust then applied for regulatory approval from the Tennessee Department of Commerce and Insurance, Division of Insurance, to purchase the Franklin American Life Insurance Company, a small, financially weak insurer. This application was subsequently approved. In this and all subsequent interactions with the insurers or with regulators, Mr. Frankel's name was never used. He always

[1] Scandal Highlights Need for Strengthened Regulatory Oversight (GAO/GGD-00-198, Sept. 19, 2000).

operated by using aliases or through fronts. See figure 1 for a timeline showing the actions of Mr. Frankel and Thunor Trust between 1985 and 1999.

Figure 1: Overview of the Scandal



A

1. 1985-1988, Mr. Frankel works in the securities industry and is fired from two firms for personal differences with management and activities subsequently leading to an SEC investigation.
2. December 1989, SEC begins a formal investigation of Mr. Frankel for omissions and misstatements to investors about his investment practices.
3. August 1992, Mr. Frankel settles with SEC and is permanently barred from the securities industry.

B

4. August 1991, Liberty National Securities registers in Tennessee and is allegedly controlled by Mr. Frankel.
5. September 1991, Mr. Frankel allegedly forms Thunor Trust using nominee grantors and files application and later buys a Tennessee insurance company.
6. February 1994 - March 1995, Thunor Trust purchases 4 more insurance companies domiciled in Mississippi, Oklahoma, and Missouri.
7. February 1998, Thunor Trust purchases an insurance company domiciled in Alabama.
8. February 1999, Thunor Trust purchases an insurance company domiciled in Arkansas.

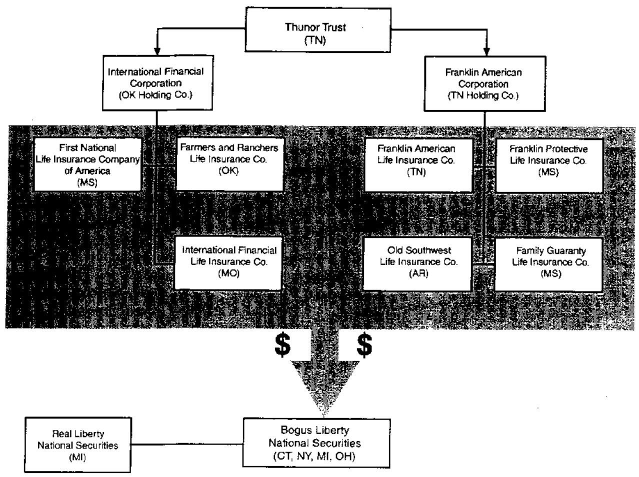
C

9. Late 1998, Tennessee and Mississippi insurance regulators became suspicious of insurers' asset custody arrangements.
10. Early May 1999, Mr. Frankel flees the U.S.
11. September - October 1999, Mr. Frankel is arrested in Germany and then indicted in federal court in Connecticut.

Source: GAO.

Over the next 8 years, Thunor Trust purchased six more insurance companies domiciled in five additional states. All of the insurance companies owned by Thunor Trust were managed out of the Franklin American headquarters in Franklin, Tennessee, even though they continued to be domiciled for regulatory purposes in the states of Mississippi, Oklahoma, Missouri, Alabama, and Arkansas. The insurer bought by Thunor Trust in Alabama was later redomesticated (moved) for regulatory purposes to Mississippi, even though it continued to be operated out of Tennessee. Figure 2 provides an overview of the Thunor Trust companies and their states of domicile when the scam collapsed.

Figure 2: Simplified Structure of the Thunor Trust Insurance Companies



Source: GAO summary of insurance regulatory data

Mr. Frankel allegedly used the same scheme to loot each of the insurance companies. After purchasing a company, Frankel removed the company's assets from the control of the insurance company, using LNS as a front. Shortly after Thunor Trust purchased an insurer, the company's assets would all be sold and apparently replaced with government bonds purchased on the insurer's behalf by LNS, acting under the direction of Mr. Frankel who operated using an alias. None of this activity involved the real LNS; rather, it was carried out by a bogus LNS operated by Mr. Frankel out of his mansion in Connecticut.

In actuality, the companies lost control of their assets when the money was turned over to LNS. Mr. Frankel's bogus company, using the name of the firm he secretly controlled—that is—the real LNS, provided monthly statements to each insurance company detailing a very active trading strategy and showing the bonds that were supposedly bought and sold that month by LNS as agent for the insurer. According to these statements, the bond trading was profitable, and the profits were returned to the company. In fact, the securities transactions shown on these statements did not happen. The statements were fabrications. It appears that Mr. Frankel actually used the company's assets to (1) return phony profits to the company, (2) purchase additional insurance companies—a necessary step to continue the fraud, and (3) support his own lavish lifestyle. Ultimately, taxpayers, other insurers, and certain policyholders will bear much of the losses resulting from the scam.

Regulatory Weaknesses

Overseeing the financial health of insurance companies can be broken down into three key phases—change of ownership approval, routine financial analyses, and on-site examinations. We observed regulatory weaknesses in each of these phases in all the states where Frankel allegedly purchased insurance companies, as well as with certain support services provided to the states by the National Association of Insurance Commissioners (NAIC). Table 1 summarizes the weaknesses we identified in each of the phases of regulatory oversight.

Table 1: Overview of Regulatory Weaknesses

Oversight phase	Weakness	Specific observations
Change in ownership approvals	*Inadequate due diligence performed on buyer application data*	- Failure to act on "red flags" associated with trust managed by a sole and irrevocable trustee that left grantors with no control over money - Inadequate questioning of prospective buyers
	Inadequate tools and procedures to validate individuals' regulatory or criminal backgrounds	- Inability to readily access regulatory history data - Inability to access criminal history data on individuals
	Lack of coordination between regulators within and outside the insurance industry	- Failure to exchange insurance regulatory concerns among states on a timely basis - Absence of an industry "clearinghouse" of insurer application data - Inability to routinely access data from other financial regulators
Routine financial analyses	*Inadequate analysis of securities investments*	- Inadequate state procedures and practices to flag high asset turnover ratios and no use of thresholds to trigger additional scrutiny - Lack of NAIC policies, procedures, or practices to assess asset turnover - Insufficient securities expertise exhibited by insurance departments to question unusual investment strategy - Lack of NAIC consolidated financial analysis of affiliated insurers in multiple states
	Ineffective mechanisms to safeguard and monitor control of insurers' securities held by another entity	- Inconsistent and ineffective policies regarding appropriate asset custodial relationships - Failure of insurance regulators to require from insurers sufficient information to allow independent verification of legitimacy and appropriateness of new custodians - Inadequate information collected annually to understand who had control of the insurers' assets
	Inadequate securities-related expertise and information gathering	- Lack of expertise to assess the viability of the insurers' investment strategy - Failure to obtain securities-related expertise from state securities regulators or from contracted assistance - Lack of communication with state securities regulators to verify the appropriateness and legitimacy of the broker-dealer
On-site examinations	*Failure to detect misappropriation of assets*	- Failure of four completed exams on companies owned by Thunor Trust to identify any material weaknesses - Inadequate examination guidelines and procedures to verify book-entry securities that were not held by a depository institution - Inadequate assessment of highly unusual investment activities - Questionable ability of insurance examiners to assess securities related activities
	Inadequate practices and procedures to verify the legitimacy of asset custodians	- Inadequate efforts to independently validate the identity and appropriateness of the asset custodian - Improperly executed custodial agreements not detected
	Limited sharing of information and coordination among regulators	- Lack of proactive alerts to warn other states of examination concerns so as to deter scam from spreading - Lack of communication with securities regulators - Lack of coordinated on-site examinations for insurers in the same group

Source: GAO analysis of insurance regulatory data.

In some cases, the identified weakness involved a lack of the appropriate policies and procedures for identifying problems in the Thunor Trust insurers. At other times, state insurance regulators failed to follow existing policies, procedures, or recommended practices. Overall, however, regulators did not act in response to "red flags" raised by the actions of Thunor Trust, the insurance companies, or the bogus LNS that served as "custodian" of the insurance company assets. These red flags did not necessarily rise to the level of illegality. But individually, and certainly collectively, they should have led regulators to ask more and harder questions—the answers to which very likely would have uncovered the scam much sooner. We believe that all financial regulators, including state insurance regulators, have a positive responsibility to act with professional skepticism. It is clear that for many years, in this case, insurance regulators did not.

Our report on the regulatory handling of the insurance companies was requested by the Ranking Member of the full Committee, Mr. Dingell, and was released this morning.[2] It provides considerable detail on each of the regulatory weaknesses identified in table 1. In my statement today, I would like to mention only a few of the more egregious examples.

During the initial change of ownership process when Thunor Trust applied to purchase its first insurance company, Franklin American Life Insurance Company, there is no indication that Tennessee insurance regulators noted any of the peculiarities or followed up with any detailed information gathering about the potential buyer. There were several unusual circumstances that could have sparked additional regulatory scrutiny. These included the fact that Thunor Trust was newly created and had no track record in the insurance industry. Moreover, the trust was established in such a way that the grantors had no control over how their money was to be used. The trust was managed by a single trustee, not one of the grantors, whose authority was irrevocable, even by the grantors, irrespective of performance. In spite of these unusual circumstances, the three grantors of the trust, those supposedly putting up the money, were never questioned, nor did we find any evidence that regulatory and criminal history background checks were performed.

Each of these and other characteristics of the trust arrangement should have raised red flags for regulators exercising professional skepticism. The federal indictment now alleges that Frankel himself established the trust, using the names of three acquaintances who never actually

[2] Scandal Highlights Need for Strengthened Regulatory Oversight (GAO/GGD-00-198, Sept.19, 2000).

contributed funds to the trust. As the sole purpose of the trust,was to purchase insurance companies, had regulators followed the money trail back to the reported sources of origin and questioned the grantors directly to validate their interests and actual control of the trust, the scam could have been uncovered at the very beginning. Moreover, there is no evidence that any state insurance regulator pursued any of these questions with the grantors of Thunor Trust when it subsequently applied to purchase insurance companies in other states.

Routine financial analysis is the analysis of annual and quarterly financial statements provided to regulators by insurance companies. These financial statements are extensive compilations of data that are used by regulators to monitor the condition and performance of insurance companies, especially those companies for which a particular state insurance department has primary regulatory responsibility, that is, their domiciliary companies. Routine financial analysis is particularly important because of the normal 3-5 year cycle for on-site examinations.

One of the peculiar characteristics of the scam was the nature of the securities activities that were reported by Thunor Trust insurers to their regulators. These activities supposedly consisted of a very active trading strategy using U. S. government bonds. During our review, we found little evidence that insurance regulators recognized or acted on concerns about the massive asset trading activity and the resulting extraordinary asset turnover ratios being reported by the Thunor Trust insurers. NAIC, which provides analytical assistance to states in the form of ratio analysis and other tools, also did not identify or address the companies' investment strategy as a problem. Similarly, the consistently greater-than-normal returns on government bond trading reported on the companies' financial statements failed to generate any regulatory skepticism or concern.

From information provided in the company financial statements filed with NAIC and the state insurance departments, we performed a simple financial ratio test structured to flag highly speculative trading activity—also referred to as an asset turnover test. The results of this analysis, highlighting the unusually high asset turnover activity, are presented in table 2.[3]

[3] This calculation method consisted of the company schedule showing assets acquired and sold each year as the numerator and total company assets as the denominator. This method was selected for illustration because it could be performed easily (or roughly estimated by visual inspection) by regulatory financial analysts. The end of calendar year numbers were used for six of the insurance company submissions during the period the companies were allegedly under Frankel's control. The remaining company, domiciled in Arkansas, was acquired shortly before the collapse of the scam, and

Table 2: Summary of Asset Turnover Ratios

Life insurance company (domicile state)	Time period (calendar year)	Asset turnover ratio (end of year average)	Asset turnover ratio (end of year range)
Franklin American (TN)	1992-98	85	10-207
International Financial Services (MO)	1994-98	54	12-115
First National of America (MS)	1998	27	27
Franklin Protective (MS)	1995-98	89	30-124
Family Guaranty (MS)	1994-98	113	30-193
Farmers and Ranchers (OK)	1994-98	119	29-204

Source: GAO analysis of insurer financial data in the annual statements.

For perspective, an asset turnover ratio of 52 would equate to selling and buying the entire value of the companies' assets weekly. By contrast, a mutual fund expert recently cited concern about equity fund managers whose asset turnovers now average about 0.9.[4]

In April 2000, NAIC officials advised us that new ratio tests to flag possible speculative asset investment activities had been developed and implemented. The threshold test for indicating abnormal investment activity is now an asset turnover of 0.25, about one-fortieth of the lowest asset turnover ratio shown for the companies in table 2.

On-site regulatory examinations of insurance companies usually take place on a 3-to-5 year cycle. Over the years that Thunor Trust owned insurance companies, the various state regulators completed four examinations on several companies. The states have told us that these examination were done in accordance with NAIC's examination guidelines. In no case were any material weaknesses identified, even though it is now alleged that Frankel embezzled the insurers' assets shortly after the companies were purchased by Thunor Trust. In every examination, the principal weakness was the examination's failure to independently verify that the companies had control over their assets, or even that those assets actually existed. Similarly, the examinations failed to independently verify the identity and appropriateness of the asset custodian reported by the companies.

Regulatory Information Sharing

At nearly every stage of the scam that we have described for you today, regulators could have exposed the fraud sooner and limited the damage if there had been better and more consistent sharing of regulatory information. Information sharing failures existed between state insurance

regulators had not yet received a quarterly statement for the period that the insurer was under Thunor Trust.

[4] Wall Street Journal, June 20, 2000.

departments and other state and federal regulators, including state securities departments, as well as among state insurance departments in different states.

For example, in the initial change of ownership process, insurance regulators could have used information on the disciplinary history of the supposed grantors of Thunor Trust. Even though Mr. Frankel's name never appeared, one of the grantors had a history of unfavorable incidents in the securities industry. This information was available on the Central Registration Depository (CRD) maintained by NASD. The CRD entries would not necessarily have been serious enough to preclude the person's association with an insurance company. However, if insurance regulators had talked to the grantors, regulators may have learned that the grantors did not provide any funds for the trust. This level of initial regulatory follow-up could have aborted the scam at its inception.

When questions concerning an insurer's investment activities did arise, insurance regulators did not generally seek regulatory data or expertise from regulators in the securities industry. A check with state securities offices of basic information on Liberty National Securities at any point throughout the 1990s could have helped unravel the investment scam. However, during our review, we did not find evidence that state insurance regulators obtained information from state securities offices during examinations completed in the mid-1990s or while conducting their annual reviews. Nor did we find that NAIC guidelines required such coordination. During our review, we collected information from several state securities offices on the real LNS that revealed major inconsistencies with the information that insurance regulators had been provided on LNS by their domiciled insurers. We reviewed information from the state securities offices on the real LNS through annual statements on file and information contained in the CRD system.

The CRD information, which was available to state insurance regulators through their state securities offices during the entire period of the scam, would have revealed that the real LNS was located in Dundee, MI, contrary to the location on the account statements insurers received from LNS. Additionally, financial statements available in state securities offices revealed that the real LNS typically had reported assets of less than $100,000 during the 1990s. Such information alone could have generated other red flags given the high level of trading that was being reported in the account statements that insurers were receiving from LNS. In addition, a check into the officers of the real LNS would have revealed an inconsistency between those actually employed by LNS and the name of an individual who was supposedly signing the asset verification documents used by state insurance regulators and a CPA firm.

Two actions taken by Thunor Trust or its insurance companies near the end of the scam clearly illustrate the inadequacy of information sharing between state insurance departments. These actions were the purchase by Thunor Trust of Old Southwest Life Insurance and a reinsurance transaction between First National Life Insurance Company of America and Settlers Life, a Virginia company. Prior to the approval to purchase Old Southwest Life in late February 1999, regulators in Tennessee were warned that Franklin American Life, the company that intended to purchase Old Southwest, might have been looted of its assets. However, this information was not conveyed to regulators in Arkansas, who approved the Old Southwest acquisition. The insurer subsequently experienced losses of over $5 million out of its $6 million in total assets. Similarly, other insurance regulators were unaware of concerns that regulators in Tennessee and Mississippi had with insurers connected to Thunor Trust in early 1999. In April 1999, Settlers Life in Virginia lost approximately $45 million through a reinsurance transaction with First National Life Insurance Company of America. If Virginia regulators had known in February that an insurer owned by Thunor Trust may have been looted of its assets, they could have asked additional questions and warned their domiciled insurers against entering into transactions with an insurer(s) connected to Thunor Trust without prior regulatory approval. In all, over $50 million was lost because important information concerning the solvency of an insurer was not shared by Tennessee with other states. After learning of the possible theft of assets from its domiciled company, instead of notifying other regulators, the Tennessee Department notified the company that it had to return the assets to a qualifying account within 60 days. While $57 million was returned to Tennessee, it was during that same period that $50 million was stolen from companies in other states.

As highlighted in the Gramm-Leach-Bliley Act, the importance of regulatory information sharing is greater than ever before. This is recognized by the law through a requirement that banking and insurance regulators share information about insurance companies and banks that become affiliated. The fraudulent activities allegedly perpetrated by Mr. Frankel further demonstrate the need for heightened coordination of oversight activities among regulators in cases where affiliated entities exist. Although the legislation is recent, insurance and banking regulators have recognized the need to improve their coordination and have taken or plan to take a number of actions. Generally, the actions consist of establishing formal agreements for sharing of information and creating working groups for periodic meetings to discuss matters of mutual interest. These regulatory actions are in their infancy, but the expected continued blurring of distinctions and separations in financial markets will require an increased and continuing commitment to enhanced regulatory cooperation in performing oversight.

Insurance regulators and the Securities and Exchange Commission (SEC) have also indicated a desire to move toward more regulatory coordination, although the Gramm-Leach-Bliley Act does not specifically address coordination between securities and insurance regulators. However, SEC officials specifically mentioned that, by statute, they could not use regulatory information from insurance regulators in determining eligibility to license brokers.

In the aftermath of the scandal, we have observed a desire by the states and NAIC to address both the known regulatory and information-sharing weaknesses associated with the scandal as well as other areas of vulnerability. Some corrective actions have already been taken. The other corrective actions proposed to date are also commendable. However, success in implementing them will require continued commitment by NAIC and the states, as some actions are expected to take several years to implement. In some cases, corrective actions will require development of model laws by NAIC, adoption of the new laws by individual state legislatures, and the development and implementation of new regulations by insurance departments. Insurance regulators will need to apply the lessons learned from this scandal to resolve existing regulatory weaknesses and effectively coordinate with their banking and securities counterparts as we enter a new environment where the blurring of historical differences in the financial sectors continues.

Conclusions

Insurance companies in several states lost in excess of $200 million through this investment scam. A fundamental aspect of the scam was the concealment of a secret affiliation alleged to exist between entities in the insurance and securities industries, in which the interests behind the ownership of the insurers as well as the investment entity controlling the insurers' assets were one and the same. The role of Mr. Frankel and others is presently the subject of a federal criminal investigation as well as other state criminal and civil actions. Taxpayers will ultimately bear much of the losses resulting from the scandal, together with policyholders who are not fully covered by their own states' insurance guarantee programs.

Insurance regulators were not prepared to prevent or detect a scam allegedly perpetrated among several insurers for nearly 8 years by a rogue broker who had migrated into the insurance industry. Although routine regulatory monitoring and examination activities are not designed to proactively look for fraud, there is a regulatory responsibility to be alert for fraud. Additional mechanisms should be in place that are designed to detect possible fraud—so called "red flags" that trigger additional regulatory scrutiny. In the scam allegedly carried out by Mr. Frankel, these red flags included peculiarities with the trust, inconsistencies in regulatory data related to asset custody and control, and the unusual investment activities being reported by insurers. Given these unusual activities and circumstances, even though they were not specifically contrary to law or regulation, insurance regulators could have reacted to the warning signals by judiciously asking additional questions. In a number of circumstances, those questions could have unraveled the scam. Clearly, in this particular case, there was a lack of professional skepticism.

In addition, long-standing information-sharing issues among federal and state financial services regulators further exacerbated the negative impacts of the scam. Insurance regulators had insufficient means for conducting background checks and measures to safeguard and verify the insurers' invested assets. In addition, state insurance regulators apparently did not have or seek sufficient expertise in the area of securities and investments to adequately scrutinize the unusual investment activities being reported to them by the Thunor Trust insurers. Similarly, the most significant information-sharing weakness observed was the inability or failure of insurance regulators to access regulatory information available from the securities industry. At each phase in the oversight process, insurance regulators would have benefited from information available through local state securities regulators to further validate the business transactions between the insurance companies and other individuals and entities. Accessing this information was neither suggested nor required, either by the policies and procedures of insurance departments or of NAIC. Finally, once regulatory concerns finally surfaced, the lack of information sharing among state insurance regulators allowed the scam to spread to other states.

We believe that it is too early to fully assess regulatory oversight coordination efforts emanating from the Gramm-Leach-Bliley Act. However, it is clear that federal and state regulators recognize the need to improve coordination as they begin implementing the financial services modernization legislation. Insurance regulators' future fraud prevention efforts will depend, in part, on the sharing of regulatory data between themselves and the banking and securities industries. Regulators in the banking and insurance industries are taking steps to formalize the coordination mechanisms through memos of understanding and the establishment of interagency working groups.

We also believe SEC and NAIC are correct in their stated need to improve their coordination. However, beyond the narrow issue of variable annuities, we are unaware of any concrete actions or plans for actions to strengthen coordination. Although the Gramm-Leach-Bliley Act does not specifically address coordination efforts between insurance and securities regulators, we believe that such coordination efforts will become increasingly important as the lines distinguishing the offerings of different financial sectors continue to blur. Moreover, the movement of undesirables from one industry to another would be more easily controlled with better sharing of disciplinary information. Overall, as illustrated by the Frankel case, each of the financial regulators needs to consider regulatory data from other financial sectors to properly oversee the business relationships and transactions between institutions in different financial sectors.

Finally, we recognize the efforts of NAIC and the states in proposing corrective actions. These actions represent an acknowledgment that the weaknesses exposed by this scam need to be corrected. As these corrective actions are implemented, the potential for a similar scam to be successful should be substantially reduced.

Recommendations

As a result of the many weaknesses in regulatory oversight and information sharing uncovered by our work, we are making a number of recommendations in our report. These recommendations are repeated here.

We recommend that state insurance commissioners:

- develop and adopt the appropriate mechanisms to adequately safeguard and verify insurer assets that are not in the physical possession of the insurance company, including requirements for ensuring the appropriateness of asset custodians;

- improve information-sharing by

  -- developing mechanisms for routinely obtaining regulatory data on individuals and firms from other financial services regulators; and

  -- implementing policies and procedures for proactively sharing regulatory concerns with other state insurance departments; and

– increase the level of securities expertise available to their departments' staff and ensure that insurance analysts and examiners have appropriate training, tools, and procedures to analyze securities assets and to recognize unusual investment strategies.

We recommend that the President of NAIC:

- ensure that the corrective actions identified by the Ad Hoc Task Force on Solvency and Anti-Fraud are implemented as quickly and fully as possible, in particular those which NAIC can accomplish unilaterally;

- ensure that the accreditation program requires the states to have adequate controls for safeguarding and verifying assets that are not in the physical possession of the insurer and to have access to securities-related expertise; and

- supplement existing guidance in financial analysis and examiner handbooks reinforcing the importance of reviewers exercising an appropriate level of professional skepticism and due professional care when indicators of fraud or other irregularities surface.

We recommend that the Chairman, SEC and the President of NAIC:

- increase the attention given to the development of more routine processes and procedures for sharing and communicating information to address common regulatory oversight matters, including efforts to help prevent the migration of rogues between the securities and insurance industries.

We recommend that the United States Attorney General, the President of NAIC, and state insurance commissioners

- work together to establish a mechanism by which state regulators can perform criminal background checks on individuals for the purpose of meeting insurance regulators' responsibilities under the federal insurance fraud prevention provision, 18 U.S.C. § 1033.

Matters For Congressional Consideration

In order to encourage and monitor progress by insurance regulators, Congress may want to consider requesting that NAIC periodically report on the status of corrective actions recommended in this report and by NAIC's Ad Hoc Task Force on Solvency and Anti-Fraud, including a discussion of

- states' adoption of appropriate laws, regulations, and processes to safeguard and verify insurer's assets that are not in the physical possession of the insurer;

- regulators' ability to access criminal history data to meet the requirements of federal insurance fraud prevention requirements, as identified in 18 U.S.C. § 1033; and

- efforts and agreements between insurance regulators and banking and securities regulators to oversee insurance-related entities of affiliated financial institutions, including methods for safeguarding and verifying insurer assets held by an affiliated institution and mechanisms to access individual disciplinary data from other financial services regulators.

Agency Comments

The state and federal agencies and other organizations commenting on our report generally concurred with the report's findings, conclusions, and recommendations.

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Mr. Chairman, this concludes my statement. My colleagues and I would be pleased to respond to any questions that you or other members of the Subcommittee may have.

Contact and Acknowledgements

For further information regarding this testimony, please contact Richard J. Hillman, Associate Director, Financial Institutions and Markets Issues, (202) 512-8678. Individuals making key contributions to this testimony included James R. Black, Lawrence D. Cluff, Thomas H. Givens III, Barry A. Kirby and Karen C. Tremba.

Mr. OXLEY. Thank you, Mr. Hillman.

Let me begin a line of questioning with Mr. Turner.

Mr. Turner, in your testimony you state that simply improving the State insurance system may not be sufficient for those insurers that compete on a national level, and you also note you fully support the ongoing efforts of the NAIC on the reform efforts. Could you give us a threshold of what you believe constitutes sufficient reform over the next several years by the States to obviate the need for an optional Federal charter?

Mr. TURNER. Let me—I will answer the question, but I don't think we have even a few years. I think this is an issue that needs to be addressed very quickly in less than a few years, but as others have mentioned, the two key areas that absolutely require improvement and uniform treatment are product approval and agent licensing, and there has to be very significant changes in the way those areas are dealt with, I think, really across all lines of insurance.

Having said that, I just want to point out an inherent problem in the current system and one we are dealing with right now, and that has to do with the privacy regulations in Gramm-Leach-Bliley where the banks and securities firms already know the regulations that they are going to be having to comply with next July where the insurance industry, because of the regulatory process, has no such knowledge and that—the limited time we have to respond to the regulations promulgated in each State really puts us at a competitive disadvantage, and this is a problem inherent in the system that really is difficult to deal with.

Mr. OXLEY. Thank you.

Mr. Nabers, should the efforts by the NAIC at some point fizzle out and Congress is unable to act to fill that void, what effect do you see on your industry, both short term and long term?

Mr. NABERS. Well, the effect would be absolutely enormous. There is no issue confronting our industry that is more serious or compelling than regulatory reform, and many in our industry consider it as a viable issue. We are moving in markets that are moving forward at breakneck speed. The Internet is contributing to this. Gramm-Leach-Bliley is contributing to this. To be in an industry where a new product cannot be marketed nationally in less than a year is an enormous handicap. So if efforts to reform the regulatory system fizzle out, I would imagine that life insurers, and really insurers throughout the country, would be at an enormous competitive disadvantage, and you might see the industry become irrelevant.

Mr. OXLEY. Let me move on. I want to follow that up later, but I want to ask Mr. Urban, as you know, you heard Mr. Smith testify that our current State system for rate filing is "inefficient, paper intensive, time consuming, arbitrary and inconsistent with the advance of technology in the regulatory reforms made in other industries." Do you agree with that statement, and how would that affect your customers?

Mr. URBAN. Mr. Chairman, with all respect as a businessperson, I could make a case that all regulation is inefficient, paper-intensive, time-consuming, and arbitrary and inconsistent at times. So I think the notion that one form of regulation is superior to another form of regulation because it removes those might be a fallacy. The fact is, what we have today is a system that in the property and casualty side of the business, we understand how it works. Probably the worst thing that I could imagine would be to make a quick decision to do away with State regulation, impose a Federal regulation and instead, what you do is you, in effect, turn upside down a multi-hundred billion dollar industry that arguably impacts every consumer, every constituent in the United States who needs to buy insurance.

It seems to us that there would be some effect to consumers if you lost State regulation, and I think the effect would be a negative one. Right today, in the State level of regulation, it is very much a one-to-one, one-on-one sort of a process relative to the consumers interest. You think about a consumer sitting in a small town, say, upper Sandusky, Ohio, who has a problem with his or her insurance, it is very easy for them to pick up the phone and call the State insurance department and have a very intimate discussion about how to solve that problem.

Our concern with doing away with State regulation going to a Federal model would be that it would just be that much more difficult for every person to ever get their local one-on-one issues ever addressed, so in our minds, we really strongly favor a coordinated unified—I heard a couple of words I like. I liked "harmonized" I heard earlier today, those seem very good words, but within the context of State regulation as opposed to Federal.

Mr. OXLEY. Mr. Mendelsohn, regarding disaster insurance, you testified that the streamline commercial lines regulatory system would bring insurance capital back into the United States. Can you elaborate on this and discuss how this might help consumers get better disaster insurance coverage?

Mr. MENDELSOHN. I think the issue is not so much disaster insurance coverage as relating to the point Mr. Urban made, the availability of capital to support the insurance business in the United States. And there is no question that whether the regulation is Federal or State, whether it is commercial lines that are deregulated or personal lines as well, what is necessary is a different system, one that allows the government to spend its money wisely on the areas that will maximize the impact on consumers. Our view is that the regulation of form and the regulation of rate, whether on the commercial side or on the personal side, is creating disincentives for investment in the American insurance industry, because it raises our costs and gets in the way of speed to market of the products that are being developed elsewhere in the world.

So I think an efficient regulatory system where Federal or State is the important issue, and that is why we support the NAIC's efforts to streamline State regulation. But on the other hand, if it does not appear that that is going to happen quickly enough, I think we have to have an alternative solution.

Mr. OXLEY. Thank you. The chairman's time has expired. The gentleman from New York.

Mr. TOWNS. Thank you, Mr. Chairman. Let me begin by asking you, Mr. Smith, you mentioned that you are licensed in 16 States, I think it is.

Mr. SMITH. Yes, that is correct.

Mr. TOWNS. And you talk about it is time consuming and expensive. Now, could you sort of describe that in terms of renewal process to every so many years you have to have your license renewed?

Mr. SMITH. Yes, I do. I have to apply to the State. The NAIC, about 2 years ago, adopted a uniform license application. Unfortunately, not all States are using that uniform license application. So you can't submit that to every State for your license. The other issue that arises then is whether or not a given State will accept the continuing education that I have imposed on me in Indiana as sufficient for my license. We are getting closer. I don't mean to be disparaging. I am trying to be factual. The NAIC, I think, has recognized that they do have a problem in licensure and they are trying to streamline it. That is why we have been working so hard on this model Act, and we think that if we can get this model Act to a point where everyone agrees on it, that we might very well be able to accomplish the reciprocity, and we are still confident that that will happen, and indeed, the requirements for Gramm-Leach-Bliley will be met.

But the process, it just takes a while. I have a secretary that does this, and it is her favorite thing to complain to me about. It is just something that takes a while to do, pure and simple.

Mr. TOWNS. Mr. Mendelsohn, I think it was you, you indicated—used the phrase, and I would like for you to expound on it a little further, "operating on a level playing field." What do you mean by that?

Mr. MENDELSOHN. Well, Congressman, essentially, in the post GLB era, we have securities firms, investment ban, insurance companies, both life and property and casualty, commercial banks, mutual fund organizations, all looking at how to deliver financial products to the consumer, products that will meet particular consumer needs. We have all of those different industries now starting to come together to compete for the consumer dollar, offering the consumer new products, new services, the technology lets you do. The concern of the industry has always been that all of the various components of that financial services business, banks, insurance companies and so on, all have the same economics affecting the production of their products and services and have the same opportunity to offer those products and services to the consumer. So that is the level playing field that we have been talking about.

Mr. TOWNS. Thank you very much. Let me go over to you, Mr. Hillman. It is true that only 12 of the 50 States have either the authority or access to the data needed to enforce the Federal prohibition against convicted felons working in the insurance business.

Mr. HILLMAN. The NAIC has reported to us that it is, indeed, yes, just a handful of insurance departments.

Mr. TOWNS. We have a lot of problems here. I noticed in terms of the discussion, in terms of whether we should do it in Federal level or State level or whatever, but let me ask the question here. How many feel that establishing a Federal commission would be a solution to the problem? I know you do Mr. Milesko, you just said you might as well raise your hand. Yes.

Mr. MILESKO. Mr. Congressman, I think what is clear, and there is a consensus here today, is that everybody thinks the current system needs to be fixed. And what we are really proposing is, let us fix the current system of State regulation, but in addition, let us offer an alternative in terms of optional Federal chartering just as we have in the banking, and let us let the companies and the agencies make their choice as to which would work best for them.

Mr. TOWNS. Let me just go back to this. I think with Mr. Urban, I am trying to keep up with these names here. You talked about a timetable. Now, if the timetable is not met, or what do you consider an adequate timetable, and if it is not met, what should happen? First, what is an adequate timetable?

Mr. URBAN. Congressman, I don't have a timetable that says by date certain X should have happened. It has taken a long time for the industry to get where it is today. It is a huge industry, many participants and constituencies to be involved. I can't imagine a quick solution is the right solution. So my timetable would be more along the lines, along steady reasonable progress, which, by the way, I think is happening.

My perspective today is the industry is far more energized toward the notion of gaining uniformity, getting consistency across States than it has, in my experience, in the business. At the NAI board level, there is actually working groups working very diligently on the same subjects that the NAIC is working on, looking for common solutions for uniformity outside of Federal regulatory solution. So my mind, is the processes to improve and to gain uniformity, to knock down some of the barriers that we have heard described here this morning? That ball is already rolling down the hill. That process has already been started.

I would like to make the point that I think that it should be given a chance to work. The energy is there. I see the commitment there. Many of the industry associations are working together in a way that they haven't in the past, and I think the end result will be a productive one. It is going to take some time, which I think it rightly should, considering the size of the industry and the impact on consumers and constituents. So I don't think that there is a short timeframe answer to this, and rightly shouldn't be.

Mr. TOWNS. The only thing I guess which would be my concern is that if, for any reason, a State doesn't comply what kind of penalties should be, I think that is the concern, because you have a lot, you are dealing with a lot of things, Governors, State legislation, you are dealing with a lot of things, so if the State doesn't comply what do you do, what do you recommend?

Mr. URBAN. I am not an expert on what you do if a State doesn't comply. It seems to me that gets to be a State rights issue, and I don't know who penalizes the State. I mean, who is the "who" in that penalizing the State discussion. So I really don't know the answer to that. I do know that there is pressure within every State to the insurance departments from the industry to get on board with some uniformity and some modernization, so it would be maybe at an insurance department's peril to ignore that sort of pressure. So it is—maybe it is not a perfect answer, but the fact is there is pressure everywhere to reform and improve the insurance operation.

I don't think anybody would argue that what we have today is perfect. Certainly the reform movement and the modernization movement is underway independent of any sort of Federal solution.

Mr. OXLEY. Gentleman's time has expired. The Chair is pleased to recognize the gentleman from Illinois, Mr. Shimkus.

Mr. SHIMKUS. Thank you, Mr. Chairman. Following up on Mr. Urban, does State regulation of insurance add value to your product?

Mr. URBAN. Yes. It adds value to the product in several ways. Insurance, in most cases, is such a personal product to buy, you are insuring your automobile or your life or your property or your home, and the need to have local understanding of the markets, of the weather, of population densities, of the local State laws or whatever it happens to be, I really think that the State regulatory process brings value to the consumer. Yes, it costs a little bit because of the need to have multiple State understanding. We do have to add to our expenses and some of the activities that we have to do to deal with that, but that is really a minor component of our cost structure, if we suddenly did away with all of that, wouldn't have a tremendous impact on the way our company operated, but it could have a tremendous impact, a negative one, I might add, to the consumers.

Mr. SHIMKUS. Following up on that, and you ended up with the consumer, which is a lot of the focus of my questions today is do the consumers feel that there is value added?

Mr. URBAN. Well, I think so. I happen to read every insurance department complaint that we get, I wish we got none, but we do get them and the consumer truly, they all sort of read like this, Mr. Commissioner, I have a problem, please help me. And I think that is a very much rubber-meets-the-road kind of situation where the consumer does believe that they get a value out of having that local State relationship, and it really works pretty effectively, because we know the regulators, they know us, much better than we could ever have possibly in some sort of a Federal regulatory environment.

Mr. SHIMKUS. Same question for Mr. Mendelsohn.

Mr. MENDELSOHN. Opposite answer.

Mr. SHIMKUS. Surprise, surprise.

Mr. MENDELSOHN. People in other parts of the world insure their lives and their homes and their automobiles. Other systems have been proven to be as effective for the consumer in those other parts of the world as our State regulatory system. In the UK where there is a single regulator, there are local ombudsmen, so that if the insured has a problem, instead of contacting the regulator, he contacts an insurance ombudsman, an advocate for the consumer. So there are different systems in different parts of the world.

What we are finding in the technology world is that a good idea for a product or service that is developed in Australia or is developed in Canada or is developed in the U.S., we can move around the world because of technology, and in jurisdictions that don't have prior product and prior price approval, you implement that product right away. Here in the United States, we commence a year-long process of negotiating with 50 separate regulators for what is a product that can be introduced in Australia or Canada or the U.S. or the UK much quicker.

So I think there are other ways of doing it. Whether those other ways are uniform State regulation or uniform Federal regulation to me is not as important as achieving the goal of speed to market and transparency for the consumer, but you can look after the consumer in different ways than we do here in the US.

Mr. SHIMKUS. This is really an amazing hearing coming on the heels of the Bridgestone/Firestone issue, State Farm obviously had been a credible company in Illinois, and one of its analysts tried to send information to the NHTSA too, and he did three times, well before a lot of the casualties had occurred. And so part of the debate is how do we provide a better clearinghouse for information? This does fall into this debate, though. Because with 50 States voluntarily sending information to NHTSA or the consumer product safety commission, how does it get sorted through, and is there a better way? Maybe NAIC can address that in some of their debates as they are trying to uniformly address other issues.

I don't want to get too far off on that, but it is timely with current events that we have seen in other hearings that have taken place.

Mr. Mendelsohn, I wanted to ask—no, let me see, I am sorry. I wanted to ask Mr. Milesko, you mentioned a product being developed if there was a national chartering, or I get the terminology wrong, but also a government secured, similar to the FDIC product that we offer for financial institutions, but you failed to mention another federally insured product that we no longer have, which is FSLIC.

Aren't we—is there not some concern that taxpayers, based upon fraudulent or misguided investment opportunities, would have to, in essence, bail out nationally chartered or sponsored insurance companies as they did with the savings and loans?

Mr. MILESKO. Well, I think Congress has learned a lot through the savings and loan crisis, and I think what we have tried to do and would hope to do is to apply that learning as we develop, you know, a national guaranty fund that would be very similar to the FDIC, which was established in 1933, and we would have a line of credit that would be put out that the companies would have to participate in. And I think it can work, the FDIC works fairly well today, but it would have to have oversight and it would have to be watched.

Mr. OXLEY. Gentleman's time has expired. Gentleman from Wisconsin, Mr. Barrett.

Mr. BARRETT. Thank you, Mr. Chairman. Thank you for holding this hearing and I want to welcome all the people here today, Mr. Milesko especially from Wisconsin. It is nice to have you here. I certainly understand the drift of the conversation that with the changes in the financial world, that there is a need for a larger playground and that the State-by-State demarcations might be somewhat outdated. So I can see the attraction to some sort of oversight at a different level.

At the same time, I am a little taken aback because from my days as a State legislator and coming here, I always thought it was unspeakable to, in any way, disturb a caring person and that the State regulation of insurance was like the 11th commandment, and that it was nothing that we should ever get involved with here at the Federal level. So hearing some of the comments today, again, takes me by surprise a little bit, and I wonder if part of it is the frustration with regulators in general, and maybe a little bit of the grass is greener on the other side, which I would caution you against, but also just the desire to try to have the dual system, and so I want to understand a little bit better the dual system that is perceived.

Mr. Mendelsohn, you seem to be one of the most aggressive advocates for it. Is this a situation, as you have sort of foreseen this, would a company make a decision to become a federally chartered company, or would it be done on a product-by-product basis? What are you looking for?

Mr. MENDELSOHN. Well, first of all, I should be clear that from the American Insurance Association standpoint, we are, at present, not advocating dual chartering. We are supporting the NAIC's effort to reform State regulation but suggesting, as Mr. Milesko has suggested, that in the event the States don't get their act together, there be this alternative available. That would be company chartering, that is, the ability to do business in the 50 States of the United States under a single Federal charter, similar to what the banks operate.

Mr. BARRETT. That would take you out of the State system entirely for every single product that that company——

Mr. MENDELSOHN. Well, no, that is what licensing of the company, the ability to do business within the State, obviously.

Mr. BARRETT. But in materials of all the oversight that you would then cast your lot with the Federal regulations, whatever they may be.

Mr. MENDELSOHN. Yes, I would say that would be, if we went down that route, that would be true in terms of the chartering, and the oversight of the company would be at the Federal level. We would advocate rate-informed freedom as well as letting the consumer and the marketplace dictate the prices at which products are sold so that the States then could turn their regulatory effort to looking over the anti-fraud solvency liquidation, those sources of issues. I think that it is the way it might work.

Mr. BARRETT. How big is the form issue?

Mr. MENDELSOHN. It is huge. If you look at any of the companies represented at this table, the number of people that we have working solely to file forms with the States, if you want to change a provision within a policy, you have got to go and file all over the place to get approval for that change. In the electronic world, that is simply not a system that makes much sense. So the approval of forms is what prevents product innovation. In the E-world, we see these people developing products and services that are sold 2 weeks later. Some succeed in the marketplace, some fail, but it is marketplace forces that decide. The concept of sitting down as we do with our E-partners and saying okay, well, that is a great idea, and we will be able to bring it to market 18 months from now; it is just, it is yesterday's world, not tomorrow's, so actually it is important.

Mr. BARRETT. You said it could take your company up to a year to get a prior time market. Is it because of the year? When you say it takes a year, what are you specifically referring to? Give me an example, please.

Mr. NABERS. Let us just say that we want to introduce a life insurance policy, a permanent life insurance policy. We would have to file that, we do business in 50 States, we would have to file that in each of the 50 States, and in each of the 50 States they had different requirements with respect to a manila insurance policy. So we would make a filing that would try to comply with requirements of each of those States ordinarily, and at least a dozen or more of the States there will be correspondence that will take place over the 6, next 6 to 12 months on this particular policy, maybe marketing materials relating to it.

So you may get approval in 35 or 40 States in the 6 months, but if you are a national company, you are going to do national advertising, you still need to wait for the rest of the States to come into line, so maybe at the end of 12 months you have approval from 48 States and you launch. If they are innovative features related to that policy something that regulators haven't seen before, you can be talking about 18 months before that policy is approved because now you are corresponding with 30 or 40 States with respect to the new features, and that has to be worked out. You send the States a letter, it takes maybe a month or so before you get response, then you try to comply with the requirements the State has imposed, so it is a very cumbersome procedure as it is currently set up.

Mr. BARRETT. If I could indulge for one follow up question, please.

Mr. GANSKE [presiding]. Without objection.

Mr. BARRETT. When I was a State legislator, I was one of the uniform law commissioners for our State, and that was a group that got together to try to make sure all the State laws were comparable and would work together. How active in the insurance field is the attempt by the States to work together to have uniform insurance laws throughout the country?

Mr. NABERS. Well, as a number of us have commented today, there is a sense of urgency within the NAIC to create uniformity within the current system. So right now there is a lot of activity to lean toward a uniform approach to product approval and whatnot. Previous to the year 2000, it was more a piecemeal approach, and sometimes if they adopted a uniform law and would make modifications to it, generally uniform laws were not adopted in all 50 States.

Mr. BARRETT. Thank you, Mr. Chairman.

Mr. GANSKE. I guess it is my turn. I have an interesting book here, the Optional Federal Chartering and Regulation of Insurance Companies edited by Peter Wallison, and there is a chapter in here by Robert Hunter, Consumer Federation of America, and I just think it might be interesting to read part of what he says.

Should there be minimal standards for all States to meet? Should Congress take over certain aspects of regulation? Which ones? How do we ensure that there is not a perverse competition from market share between a State charter and a Federal charter through lax regulation between States and Federal Government as there is between some States right now? Should the antitrust exemption be maintained? Could certain efficiencies in money and time be achieved by centralizing certain functions? And I would add to that, while efficiency is important, I think security is important also for the industry.

He goes on, Congress has to consider the Federal history with respect to insurance regulation, which can be summed up in three words: “what, me worry?” The Federal Government’s total lack of capacity to understand insurance is troubling. Consider these examples. When Mr. Hunter testified before Congress during the last liability crisis, he appeared on the same morning as the chairman of the FTC. The chairman had no prepared statement. When he was asked to explain what the FTC thought was causing the crisis, he answered he did not know, and if he did know, he would be breaking the law. That was because Congress had taken away the FTC’s right to study insurance in 1980. It seems that the FTC had been punished for having had the audacity to tell consumers that whole life insurance was not a good deal. That should give pause to those who think that a Federal role would automatically be better, whichever side you are on that one.

And then he goes on to say, the Supreme Court has ruled that ERISA preempts State insurance regulation. That ruling has created a regulatory black hole wherein consumers can fall to their death. As bad as State regulation has been, it has never allowed an insurer to change the rules after a claim occurs. Yet the United States Supreme Court allowed an insurer to lower AIDS coverage from $1 million to $5,000 after a man became ill with the disease.

He concludes, as Congress considers the possibility of some Federal role in insurance, it should not fall into the “either/or” trap as some might say. The Federal role might be an optional one, partial one, minimal standards, technical assistance, or some other new approach.

Before asking you to comment on that, we have had testimony here before the National Conference of Insurance Legislators, and they had this in their testimony. The essential question is this: Is there a way to preserve the system of State-based regulation, and at the same time, accommodate the need for national licensing, or as some have called it, national chartering, and they think there is a way. That way is through interstate compacts. Under a compact, a State could enact licensing or chartering rules that would have full force of law in each of the compact jurisdictions across State lines.

The establishment of an interstate compact for insurance regulation would require a single uncomplicated legislative Act in each compacting State. States that wish to join the compact would enact that legislation. It would provide for establishment of a compact agency that would act through a governing body. The governing body would include insurance commissioners from each compacting State. The compact agency would have legal standing in State laws and courts, and it would be accountable to the governments of the compacting States.

My question is this: What do you think of NCOIL’s proposal, should we be pushing for State compacts?

Mr. Urban. And if you want to comment on the statement by Mr. Hunter, feel free.

Mr. URBAN. First of all, on compact, I am not an expert on that. That sounds like an interesting concept. It doesn’t sound so different from the notion of the industry working with the members of the NAIC to come up with common rules of modernization and uniformity. So within that arena, seems like it might be a reasonable approach.

On the Bob Hunter comments, I find myself in sort of an uncomfortable position, frankly, for the first time in my professional life. I might actually agree with Mr. Hunter on some of his points. I can't imagine a worse environment for an insurance company and consumers than having a company be able to choose to be regulated at the State level or to be regulate d at the Federal level. There would be an almost intense pressure for the two to have different regulatory approaches to the same industry. So you would have companies operating side by side in the same States selling to the same consumers regulated in a different fashion. I can't imagine how that is good for consumers, certainly know that wouldn't be good for companies. And my view of regulation, probably the worst outcome would be the dual option, Federal regulation would be slightly less onerous.

Mr. GANSKE. Mr. Nabers, you probably don't agree with that, but would you comment on the NCOIL's proposal?

Mr. NABERS. Yes. The NAIC is studying quite intensely the use of interstate compacts that create the kind of uniformity that we in the industry seek, and the NAIC wants to give, and I think that is probably the best route for the NAIC to take in achieving the kind of uniformity that we seek, and I am certainly no expert on interstate compacts. I do know that they have been used successfully in the banking field with respect to bank regulation or State regulation of banks.

So I certainly think that it is an idea that needs to be pursued, though your statement says the legislation that would be enacted in the various States is simple legislation. That is true. The seeding of authority from legislative bodies to insurance commissioners and insurance commissioners to a central regulatory group is something that is going to take a lot of thought and political understanding to accomplish. But the concept, I think, is a sound one, and the NAIC is studying it.

Mr. GANSKE. Mr. Mendelsohn, does the AIA have a position on interstate compacts? Do you think this is a good way we ought to look at going?

Mr. MENDELSOHN. Well, obviously, we, like the other associations, are studying all of the alternative ways and have not yet taken a public position on that. I think that the one common thread that I see in all of this is a recognition that the current way of doing business of the 19th century regulatory system is not working in the 21st century, and all, regardless of the political point of view that we bring to the table, agree that radical change is necessary in how we work.

Whether that is by way of compact, by way of the States, voluntarily working together or the Federal Government having to take a role, my personal view is it is very difficult to get 50 State legislatures or 50 State insurance commissioners to radically change the way they do business, and therefore, there is going to have to be some central Federal prodding along of the process. And I think that, the difference of views that you have heard this morning is about how we fix the existing system. There is not a tremendous amount of debate about whether the existing system needs to be fixed.

Mr. GANSKE. I thank you, and looks like I have used up my time. So the gentleman from Minnesota, Mr. Luther.

Mr. LUTHER. Well, thank you, Mr. Chairman and first, I want to welcome Mr. Turner from Minneapolis here, very nice to see you. And thanks for sharing your expertise with the committee. I just want to ask a question, Mr. Turner, and perhaps any others, too, just to really to inform the committee, on the whole issue of State privacy laws, if you could comment, give us your thoughts on State privacy law, the impact of the Financial Services Modernization Act and the OCC on those laws, and whether you would support any additional Federal legislation, and perhaps others that have thoughts can join in too. But I would appreciate your thoughts on that.

Mr. TURNER. Well, privacy is a very important subject for us, and for really all Americans, and I guess our position currently is, it is appropriate to move toward the implementation of the Gramm-Leach-Bliley criteria for privacy regulation at the State level. That is a good starting point to put all financial services industries on an equal basis. And we certainly support as an industry moving in that direction. Obviously, there are elements of the privacy debate that probably go beyond the Gramm-Leach-Bliley criteria, and those are issues that will have to be dealt with over time but I think certainly, job one is to effectuate or implement the Gramm-Leach-Bliley ground rules.

Mr. LUTHER. If there is anyone else that wishes to comment, and on that whole issue then of the preemption, that preemption issue, the OCC, any further comments or thoughts that you or others would have on that issue?

Mr. TURNER. Can you clarify the nature of the preemption issue?

Mr. LUTHER. Well, just, I think the issue being whether that, the State model that Minnesota and some other States have enacted, how that, the effect of that in view of the passage of the legislation, and whether or not that would be preempted by the Federal legislation, or if additional legislation would be needed from your point of view.

Mr. TURNER. I am not familiar enough with the subject.

Mr. SMITH. The Independent Insurance Agents of America would believe that, indeed, those State laws should not be preempted, that the States had the right to enact those laws, they have enacted those for their consumers, their State has done that and we believe that those laws should remain as they are and not be preempted by the OCC.

Mr. LUTHER. Any other comments from any of the panelists on that issue? Okay. Thank you. Thank you, Mr. Turner, nice to have you here. I yield back, Mr. Chairman, thank you.

Mr. OXLEY. The gentleman from Illinois, Mr. Rush.

Mr. RUSH. Thank you, Mr. Chairman. I want to thank the panelists also for their testimony, and I want to get right to my question. Mr. Mendelsohn, you and I see eye to eye on the fact that the collective effort needed between Federal and States for this reform, but I think we differ in that on the question of whether it would have a market-based approach to insurance regulation without prior government review or approval of prices or products, which I think would be beneficial to the consumers. Can you suggest how a market-based approach would permit competitive companies to provide services, product, that is, in the best interest of the consumers?

Mr. MENDELSOHN. Certainly. The innovations in products and services that we are seeing around the world today are being driven in large part by the market, changes in technology, changes in the ability to offer financial products, blended financial products, risks being covered in different ways than they have before. And it is true that in many jurisdictions today, the ability to introduce those products takes a very, very long time.

In a system in which rate and form is unregulated, then essentially innovation, the best products win in the marketplace. The consumer will buy the product that delivers the best value to them, and what we see in other countries and certainly in the UK when a good idea comes up and a company starts selling a product, if it is successful in the marketplace because it meets consumer needs, other companies then copy it, drive down the costs.

My view is that the whole by-product of the electronic world is the customer becomes truly the king, the customer can go on the Internet and see what products and services are on offer anywhere in the world, and ultimately, it is they, not we, who are going to drive reform. They are going to demand access to these products and services. And they do work in other places.

When we look at the advance here in the United States now, we have prior approval of rate in some States, open rating in others. Clearly the open model is a much faster and more flexible model, and as long as one of my other panelists said this morning, as long as we have a competitive marketplace, and my goodness, here in the U.S. with thousands of insurance companies, we have a competitive marketplace, people compete to offer the best product at the lowest price. And it is my belief that the prior approval of the nature of the products slows that process down. Bureaucrats, with all due respect, react to things that are different from what they saw before by slowing the process down instead of letting those products go to the marketplace and succeed or fail, based on their own merits. That is my personal view.

Mr. RUSH. Thank you. I want to ask Mr.—maybe you can take a shot at this one, too. My constituents are mostly concerned not only in terms of the strength and viability and competitiveness of the industry, but they are also concerned about insurance abuses, particularly such as redlining, and frankly, I am encouraged by that the OCC, and now that it is engaged in agreements with several State insurance departments in an effort to share information concerning consumer complaints. My question is, aside from simply collecting of data of consumer complaints, should there be more of a proactive search for data on insurance abuses, such as redlining?

Mr. MENDELSOHN. Well, I think that again, whether we have Federal regulation or State regulation, it is incumbent upon the regulator to make sure that there is a level playing field for the consumer, just as we are asking for a level playing field among the financial institutions.

And, again, I don't view that issue as being one that depends on what kind of regulation we have. The regulator, the ombudsman, whatever we call the person responsible for products and services provided, has to ensure that they are provided on a level playing field. So I don't really see that as a Federal versus State issue, Congressman. I think that's incumbent—it is in the industry's best interest that we treat the consumers on a level playing field and I think it is in the government—whether it is State or Federal's best interest to make sure that the regulator looks at us and makes sure that that is happening.

Mr. OXLEY. The gentleman's time has expired. The Chair is pleased to recognize the ranking member of the full committee, the gentleman from Michigan, Mr. Dingell.

Mr. DINGELL. Mr. Chairman, first of all, I thank you. Second of all, I commend you for these hearings. Third of all, I note that as Yogi Berra used to say, "This is deja vu all over again." It seems like every time we read about the States and insurance regulation, we find that it is written about in connection with some massive rascality which has gone on uncaught by the State regulators.

So I have a few questions here for Mr. Hillman.

Mr. Hillman, do you think it is fair to characterize the performance of State insurance regulators and this Frankel case as a travesty?

Mr. HILLMAN. Certainly a travesty of effective insurance regulation, Congressman.

Mr. DINGELL. Now, had State insurance regulators checked with State securities regulators about Liberty National Securities, the firm Frankel said he had been using to invest insurance company assets would they have been alerted to the fact that fraud was underway?

Mr. HILLMAN. Yes. There are a number of inconsistencies that such a check would have revealed, and caused regulators to ask additional questions. For example, the address of the real Liberty National Securities registered with the securities regulators did not match addresses on the account statements of insurance companies. Second, the officers of the real Liberty National Securities did not match the names of individuals signing the asset confirmations being sent to the insurance companies and to regulators.

Finally, the real Liberty National Securities had reported assets of less than $100,000. Certainly that level of assets couldn't support the massive trading activity that that securities firm said they were conducting.

Mr. DINGELL. The scam began in 1991. If insurance regulators had checked with securities regulators as early as 1991, would it not have been possible for the regulators to see that fraud was going on; and if not, would it not have been detected much earlier?

Mr. HILLMAN. Yes, it would be possible to detect a fraud much earlier. For example, if the insurance regulators had access to information that the securities regulators had from their CRD system, they may have found that one of the grantors showed a disciplinary record. Upon further review and discussions with that grantor, they would have learned that that grantor actually wasn't putting up the funds. And through questioning such as this, they may have been able to uncover this much sooner.

Mr. DINGELL. Is there any reason why State insurance regulators cannot and did not check with state securities regulators in this matter?

Mr. HILLMAN. No, there is no reason why they couldn't check with securities regulators.

Mr. DINGELL. Your report says that Tennessee regulators performed four, four onsite examinations of Frankel-controlled insurers and did not find any material weaknesses, even though Frankel had already embezzled insurers' assets before the examinations were conducted. How is it possible for insurance examiners to miss the fact that a company's assets were no longer there?

Mr. HILLMAN. Mr. Congressman, our report says that, as you say, that there were four onsite examinations conducted. They weren't all done in Tennessee. One was done in Oklahoma, Tennessee, Missouri. Better enforcement procedures, better enforcement of existing procedures is certainly a method that could have been used. NAIC has a model law, I believe it is number 295, where companies are only supposed to accept statements from national banks or State banks or trusts and hold those assets in those organizations. In our review, and in this instance, those were held by a securities firm which is inconsistent with this model law.

Mr. DINGELL. Why didn't they find the fraud?

Mr. HILLMAN. In our view, it was simply a lack of professional skepticism.

Mr. DINGELL. Now, in your statement you noted that the Frankel Insurance Company's assets were reported to be invested in government securities, that in many cases the total assets of the company were completely turned over every business day. Can you think of any legitimate business strategy that would justify these high turnover ratios, and why didn't State regulators question the high levels of reported trading activity? In the stock markets, this would be call churning.

Mr. HILLMAN. Exactly. I see no legitimate reason for these high asset turnover ratios, particularly in an insurance company. In our view, the reasons State regulators didn't question this activity included a couple of factors. First, the lack of securities-related expertise to assess risks, and second, a lack of guidance available by NAIC to flag a high asset turnover ratio and a risky practice such as this.

Mr. DINGELL. Were the profits that Frankel reported as investments in government securities typical of what investments in other government securities were earning?

Mr. HILLMAN. The reported earnings were often higher than normal market returns.

Mr. DINGELL. Wouldn't that constitute a warning to anyone who did an audit?

Mr. HILLMAN. It certainly should.

Mr. DINGELL. Now, when an examiner for the Tennessee Department of Commerce and Insurance determined on February 1, 1999, that it was a possibility that Mr. Frankel's insurance company, "had been looted of its assets," the Tennessee department did not warn the public or other State regulators, did it?

Mr. HILLMAN. During our review we found no evidence that the information was proactively shared with other State regulators to help prevent the possibility of a potential scam from spreading.

Mr. DINGELL. If that warning had been sent out, would it not have alerted both other regulators and the public at large to the fact that this company was being looted?

Mr. HILLMAN. It could very well have.

Mr. DINGELL. Is it your understanding that instead of alerting regulators in other States, the State of Tennessee chose to ask Mr. Frankel to redeposit the assets of Franklin American Life Insurance Company in a qualified bank account within 60 days?

Mr. HILLMAN. Yes, to the best of my knowledge.

Mr. DINGELL. Isn't this a little bit like saying I know you have been stealing from me but I am giving you 60 days to steal from someone else so that you can pay me back?

Mr. HILLMAN. I can't speculate on their motives. However——

Mr. DINGELL. Did Franklin during this period of time purchase an additional insurance company in Arkansas for $5 million and enter into a fraudulent reinsurance scam with Settler's Life in Virginia that gave him another $45 million?

Mr. HILLMAN. He did indeed.

Mr. DINGELL. Now, the money that Mr. Frankel used to deposit in an account in Tennessee came from money stolen then from two other insurance companies during the 60-day period the Tennessee regulators gave him; is that correct?

Mr. HILLMAN. That is correct.

Mr. DINGELL. Now, did regulators in Arkansas or Virginia contact Tennessee's regulators, or did Tennessee's regulators contact the regulators in those two States asking for information about the activities of Franklin American and those who control it?

Mr. HILLMAN. We found no evidence documenting such communication. However——

Mr. DINGELL. Do you believe that in fraud cases of this type, the present state of 50 independent State insurance regulators makes each regulator put too high a priority on taking care of policies in his or her own State instead of exposing fraud that affects policyholders in other States?

Mr. HILLMAN. We believe there is little incentive on the part of State insurance departments to tell another State about problems with a domestic insurer, principally because that could exacerbate those problems as other States act to protect their own policyholders.

Mr. DINGELL. Would I be fair in inferring that only 12 of 50 States have either the authority or access to data needed to enforce Federal prohibition against convicted felons working in insurance businesses?

Mr. HILLMAN. According to the NAIC, only a handful of States have the ability to access criminal history data.

Mr. DINGELL. So an adequate enforcement authority at the State level is a problem here, is it not?

Mr. HILLMAN. Yes, it certainly is. Right now the States and NAIC indicate that they do not currently have a mechanism to obtain criminal history data that would allow them to identify persons with a criminal record that are trying to enter the insurance business.

Mr. DINGELL. Now that Gramm-Leach-Bliley has become law, fraud in one financial section, like insurance, can affect banks and securities firms as well. Is it true that Connecticut is the only State to have a memorandum of understanding with the Federal Reserve providing for the sharing of information in cases where banks and insurance companies are affiliated?

Mr. HILLMAN. That is true. To date, the Federal Reserve has one MOU with the State of Connecticut as a result of the Citigroup merger involving Travelers Insurance Company, though additional MOUs are anticipated. We also are aware that the OTS and OCC have entered into MOUs with a number of States.

Mr. DINGELL. Isn't it fair to observe that the inability or the failure of the reluctance to share information creates serious problems for regulators in both industries?

Mr. HILLMAN. Yes. It may be a serious problem if regulators do not share regulatory information on affiliates across industry sectors or regulatory information on undesirables to prevent the migration of rogues from one industry to another.

Mr. DINGELL. Mr. Chairman, you have been overly generous with time. I thank you. I have other questions but I will wait for another time.

Mr. OXLEY. I thank the gentleman. The Chair would indicate that written questions may be posed to any of the panel members.

Mr. DINGELL. With the permission of the Chair, I will submit additional questions for the record of Mr. Hillman, and I want to thank him and the panel, but I particularly want to thank you for your courtesy to me.

Mr. OXLEY. Without objection.

We thank all of our panel for an excellent discussion. Some very, very pressing issues. The subcommittee stands adjourned.

[Whereupon, at 12:22 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

GENERAL ACCOUNTING OFFICE RESPONSE TO QUESTIONS FROM THE HONORABLE TOM BLILEY, CHAIRMAN, HOUSE COMMERCE COMMITTEE

Question 1. Now that Congress allowed private-sector financial integration with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Response. We would like to highlight two critical coordination issues. First, regulators need to share supervisory information about those institutions that choose to affiliate across sectors in the financial industry. This need is addressed in Gramm-Leach-Bliley for bank and insurance regulators, but securities regulators were not included. While it is too early for definitive answers, our work shows a desire to improve coordination on the part of all regulators. However, securities regulators have been less active in looking for mechanisms to improve interindustry coordination. Difficulties remain in successfully sharing supervisory information among regulators. For example, in some states, confidentiality laws exist that preclude sharing of examination workpapers, even with other insurance regulators. Second, in order to inhibit the migration of rogues from one industry to another, there needs to be sharing of information about the history of individuals who have been subject to disciplinary actions in banking, securities or insurance. The mechanism for sharing this type of information needs to be easy enough to make both adding information and cross-checking routine for all regulators.

Question 2. If the States fail to act on the NAIC's proposed reforms, and no alternatives are forthcoming from Congress, what would the costs be to the American consumers?

Response. We have not reviewed ongoing uniformity initiatives being developed by NAIC and the states. If the Committee desires, we could discuss future work in this area. However, if insurance regulation remains in its present form, one cost to the American consumers would be unnecessary vulnerability to frauds such as that allegedly perpetrated by Martin Frankel.

Question 3. According to your report, "At nearly every stage of the scam that we have described for you today, regulators could have exposed the fraud sooner and limited the damage if there had been better and more consistent sharing of regulatory information." Congress mandated better coordination among the agencies in Gramm-Leach-Bliley, but there appears to be some resistance. Can you describe the critical avenues of communication that you believe should be taking place?

Response. Improved regulatory communication needs to occur at all levels, including between state and federal financial regulators, between state financial regulators of different industries, and between insurance regulators in different states. The barriers to effective communication, in most cases, are not legal but rather institutional and cultural. In the Frankel matter, had state insurance regulators accessed basic information from state securities regulators, the scam could have been uncovered much sooner. Furthermore, when suspicions of fraud finally surfaced, a proactive alert to other insurance regulators could have prevented the scam from spreading further and limited the damages.

Question 4. If the NASD and NAIC databases performed automatic checks on unfavorable incidents of matching names, or if review of insurers trading activities and the condition or location of securities traders were coordinated between the SEC and NAIC, could we have stopped Martin Frankel earlier?

Response. Yes, we believe so if such checks were routinely done. In the Frankel case, regulators did not access broker-dealer information until 1999, or many years after the scam began in 1991. Early checks would have revealed discrepancies about the size of the broker-dealer (Liberty National Securities), its location, and its trading activity. Had regulators followed up on the discrepancies at an early stage, we believe it is much more likely the fraud would have been detected. Regarding name checks, Frankel never used his real name in the insurance industry so such checks would not have helped in this case. However, name checks of the grantors of Thunor Trust would have revealed unfavorable incidents with one of the grantors in the securities industry. Additional scrutiny by the regulators of the grantors and their sources of funds may have led to earlier detection of the scam.

Question 5. If the State insurance commissioners implemented uniform solvency regulation through a centralized system, could Martin Frankel have been stopped sooner?

Response. It would depend upon what was included in a uniform system. For example, we believe Frankel could have been stopped sooner if the system had included such things as (1) routine background checks of insurance company principals across financial industry sectors, (2) routine intra and interstate information sharing among all financial regulators and (3) appropriate laws, regulations, and processes to safeguard and verity insurer's assets that are not in the physical possession of the insurer.

Question 6. The SEC says that they are prevented by statute from using regulatory information from insurance regulators to discipline brokers. But couldn't they use the information to put brokers on their watch or investigation lists?

Response. It seems reasonable to us that disciplinary information from both insurance regulators and from bank regulators could be used in this fashion. However, SEC, in commenting on our report, did not indicate this ability.

Question 7. Do you believe that the financial regulators will coordinate their efforts on their own without further oversight or pressure from Congress?

Response. We believe some coordination would occur. However, continued active oversight by Congress should increase the likelihood of more substantive progress. For example, on Page 50 of our report we suggest Congress may want to request that NAIC periodically report to Congress on the implementation of its corrective actions in order to encourage and monitor progress by regulators. We specifically suggest that such a report to Congress include efforts and agreements between insurance regulators and banking and securities regulators.

Question 8. If we don't ensure better coordination between our insurance, banking and securities regulators, could Martin Frankel happen again?

Response. Yes. Even with better coordination, fraud still can happen. Improved coordination among regulators makes earlier detection of fraud more likely.

Question 9. What does Congress need to do to enable the State regulators to coordinate with the Attorney General in performing criminal background checks to prevent fraud?

Response. This is an area that needs continued attention. However, it is clear to us that state insurance regulators need to be on par with their counterparts in the banking and securities industries to perform routine criminal history checks on individuals seeking to enter the insurance industry. Some state insurance regulators, per their own state statutes, have the ability to conduct criminal background checks on industry applicants while others do not. Justice officials agreed with the NAIC that most state insurance regulators do not have legal access to nationwide criminal history data. Congress could solve this problem by providing a legislative basis for giving state insurance regulators the right to obtain the results of nationwide criminal history background checks on individuals, similar to those currently performed by the FBI for banking and securities regulators.

AMERICAN BANKERS ASSOCIATION INSURANCE ASSOCIATION
October 2, 2000

The Honorable THOMAS J. BLILEY, JR.
Chairman
Committee on Commerce
United States House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515-6115

DEAR CHAIRMAN BLILEY: Thank you for your questions regarding my testimony on improving the uniformity and efficiency of insurance regulation, which I presented to the Subcommittee on Financial Hazardous Materials on September 19, 2000, on behalf of the American Bankers Association Insurance Association (ABAIA). My responses to your questions appear below. In each case, I repeat your question then provide a response.

Question 1: How much progress has the NAIC made in the last two months on achieving uniformity, and how much faith should we be placing in their efforts?

Response: ABAIA applauds the NAIC's efforts to achieve greater uniformity of state insurance regulation and hopes that it is successful in those efforts. However, we have serious doubts about the NAIC's ability to achieve this goal. In order to be successful, the NAIC must not only obtain the agreement of 50 state insurance commissioners, but also the agreement of 50 state legislatures. The NAIC has a good record in developing model laws and regulations. However, its record in having those model laws and regulations actually adopted by all states is not so successful. In many cases, the NAIC has been unable to have its model laws adopted uniformly by the States.

Question 2: What are the minimum results we should insist on from the NAIC effort, and what sort of time-lines can Congress reasonably expect for implementation?

Response: At a minimum, the States should focus on uniform licensing requirements, product consistency, speed to market and privacy. Anything less than complete uniformity in these areas will continue to deny new products to consumers and will continue to impose unnecessary regulatory costs on the industry. Time is of the essence. Consumer needs and technological changes, especially changes brought about by the Internet, demand the immediate elimination of regulatory inefficiencies.

Question 3: What can Congress and the industry do to help the States achieve uniformity?

Response: ABAIA believes that the enactment of an optional federal charter for insurance companies and insurance agencies is the best way to achieve uniform regulation of insurance. Concurrent with the enactment of such a proposal, we urge the Congress to continue to press the States on uniformity. In the early 1990s, Congressional oversight on solvency issues forced many useful changes in state regulation.

Question 4: If the States are unable to make progress in implementing uniformity reforms over the next year, what alternatives should Congress consider?

Response: Again, we believe that the enactment of an optional federal charter is the answer to uniform regulation. Dual chartering has worked well in the banking industry for over 135 years, and, as we explained in our testimony, it would benefit consumers, the industry and state regulators.

Question 5: What are the easiest issues for the States to achieve before moving on to the more comprehensive uniformity issues?

Response: The two most pressing issues are uniform licensing and product approval. Conflicting licensing requirements are a clear impediment to the delivery of insurance products to consumers. Similarly, delays in approval of products rob consumers of product choice and innovation. The average life of a new product is six months, yet it can take eighteen months or more to get a new product approved by the various states.

Question 6: Now that Congress has allowed private-sector financial integration with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Response: Information sharing among state regulators and between state and federal regulators is critical, especially the sharing of information regarding problem agents and companies. Also, to the extent possible, it would be useful to have joint examinations and periodic meetings between regulators.

Question 7: If the States fail to act on the NAIC's proposed reforms, and no alternatives are forthcoming from Congress, what would the costs be to the American consumers?

Response: The current regulatory structure is overly complex and inefficient. This makes it difficult for consumers to compare alternative products and it increases the cost of insurance for consumers. Uniform regulation through an optional federal charter would permit the development of uniform policy forms, ease the distribution of insurance, permit consumers to more easily compare policies, and introduce greater price competition for products.

Question 8: According to your written testimony, "Most States are currently unclear on advertising requirements for Internet sales and whether filing of sales materials is required." Since the Internet is by nature a global entity without State borders, how can insurers comply with 50 different State laws for the same advertisement without a Federal or national regulatory system?

Response: This is a good example of the problems insurers and agents face under the current state system. The Internet is an efficient means for insurers to market insurance and for consumers to purchase insurance. However, as the States impose different advertising, licensing and disclosure requirements on Internet insurance transactions, the industry and consumers cannot fully take advantage of the Internet.

Question 9: You testified that the dual chartering option for banks has not resulted in a race to the bottom, but has instead created a healthy competition between state and federal banking regulators. What kind of benefits might consumers expect from this healthy competition?

Response: Some of the consumer benefits that would flow to consumers as under an optional federal charter include greater product uniformity, better product distribution, greater product innovation and more price competition.

Question 10: You testified that a consumer should be able to receive the same policy regardless of where the consumer resides. But Mr. Urban testified that local market conditions can affect the product and price in the property/casualty industry, with local concerns such as tort law, weather, population density and traffic congestion affecting the product regulation. Can you comment on this?

Response: The various states require that property and casualty policies include various provisions, not all of which are the same. A federally chartered insurance company would be able to issue policies subject only to the terms and conditions required by the federal insurance commissioner, not the various state commissioners. Also, with respect to the applicable rate for such a policy, it would be possible for a federal insurer to develop a blended rate that is based upon national risks, just as insurers develop rates based upon state risks today.

Question 11: You testified that the proposal from the ABAIA would prohibit the new Federal regulator from imposing any rate requirements or policy pre-approvals. You also quoted a recent study which found that auto insurance is less costly and more available in the 14 states that do not require prior approval of rates than in the 27 other states that do require prior approval. Why do the states have rate approval requirements, and is ABAIA's proposal politically feasible?

Response: Rate regulation was originally intended to ensure that companies did not jeopardize their solvency through mispricing. Today, there are other, more direct ways, to supervise solvency. Furthermore, several states have moved to reduce or eliminate rate regulation. Illinois is an example, and Mr. Urban, who appeared before the Subcommittee on behalf of the National Association of Mutual Insurance Companies, told the Subcommittee "Illinois is a highly competitive state. Products are available, innovation is rapid and citizens pay fair, competitive prices for insurance."

Sincerely,

GLEN J. MILESKO
President and Chief Executive Officer
Banc One Insurance Services Corporation

AMERICAN COUNCIL OF LIFE INSURERS
October 2, 2000

The Honorable TOM BLILEY, *Chairman*
Committee on Commerce
U.S. House of Representatives
Rayburn House Office Building
Washington, DC 20515-6115

DEAR MR CHAIRMAN: I appreciate your interest in increasing the uniformity and efficiency of the insurance regulatory system. As I indicated in my written statement before the subcommittee, this issue is now a matter of great urgency for our business.

My answers to your questions follow. If there are any additional questions you have or if I can provide you or your staff with any additional information, please do not hesitate to contact me.

Question 1. How much progress has the NAIC made in the last two months on achieving uniformity, and how much faith should we be placing in their efforts?

Response 1. The NAIC has made exceptional progress in developing a conceptual framework for making the state-based system of regulation more efficient. Of course, some aspects of the changes the NAIC and life insurers seek may necessitate legislation, and state legislatures will have to cooperate with state insurance regulators and the NAIC to bring about needed reform in a uniform manner. One area where the NAIC is making significant progress involves agent licensing. The NAIC has just completed a two-year effort to develop a model agent licensing law which, if enacted by the states on a uniform basis, will establish the foundation upon which a national agent licensing system can be built. However, if states insist on retaining their own unique requirements and adopt the model law with material deviations, the uniformity needed to support a national licensing system will never materialize. In short, the open question is whether the NAIC and the states will ultimately be able to translate concept into actual regulatory efficiency, and do so to the extent necessary to meet the demands of today's insurance marketplace.

Question 2. What are the minimum results we should insist on from the NAIC effort, and what sort of time-lines can Congress reasonably expect for implementation?

Response 2. From the outset, the ACLI has set a clear objective for an efficient state-based system of life insurance regulation: uniform standards, consistent interpretations of those standards; and a single point of contact for dealing with multiple jurisdictions. The more this objective can be achieved in the critical areas identified in the ACLI study of regulation and in the CEO survey appended to our statement, the greater the NAIC's measure of success. Though time is of the essence, the ACLI has not set a timetable for this task. Since we believe state regulation will always be an important component of the insurance regulatory landscape, we will work to make it more efficient regardless of how long it takes.

Question 3. What can Congress and the industry do to help the States achieve uniformity?

Response 3. The states may conclude that they need assistance from Congress (e.g., something conceptually akin to NARAB in Gramm-Leach-Bliley) to achieve the degree of uniformity necessary to put in place a modernized system of insurance regulation. The ACLI would be supportive of such a concept.

Question 4. If the States are unable to make progress in implementing uniformity reforms over the next year, what alternatives should Congress consider?

Response 4. This question and Question 11 raise an important point. Understandably, the NAIC views its progress toward an efficient system of regulation as having a direct bearing on the need for Congress to consider alternatives, including an optional federal insurance charter. And there are certainly those in the insurance industry that share that perspective. Others, however, do not directly link improvements to a state-based system of insurance regulation to the question of whether an optional federal charter or some other avenue to regulatory efficiency should be pursued. For example, many life insurers simply believe there should be a dual charter system for insurers. They want both an efficient state charter option and a workable federal alternative, and believe both should be aggressively pursued at the same time.

Question 5. What are the easiest issues for the States to achieve before moving on to the more comprehensive uniformity issues?

Response 5. As noted in the answer to Question 1, the NAIC has made significant progress in the area of agent licensing. A model law has been completed, and the NAIC has developed the infrastructure that will support a centralized, automated agent licensing system. This issue is farther along in the development stage than many other important issues, due in large part to the pressure applied on the states by the NARAB provisions of the Gramm-Leach-Bliley Act. In fact, many believe that the degree of uniformity achieved by the states in this area will be predictive of the overall success of the NAIC's regulatory reform agenda. We have also developed recommendations for improving the timing, scope and coordination of the multi-state market conduct examination process, which can be implemented quickly and without the need for legislation while a long-term solution to this issue is devised. Additionally, the company licensing process (for authority to do business in a state) could be markedly improved in the short-term if states participate in the NAIC's ALERT initiative and agree to uniform company admission standards. Finally, while the multi-state product approval process is one of the more complicated issues to address, a comprehensive solution is urgently needed for insurers to compete successfully in rapidly changing markets and to help correct the growing competitive imbalance between life insurers and other financial services providers.

Question 6. Now that Congress has allowed private-sector financial integration with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Response 6. Communicating relevant information between and among the various financial service functional regulators is imperative. As firms increasingly diversify, this coordination will be even more important. Beyond that, the ACLI would not support merging functional financial service regulators. We believe the regulatory needs of insurers, banks, mutual funds, and securities firms are quite different and necessitate unique regulatory expertise. We believe functional regulators dedicated to the particular needs and circumstances of the firms and markets they oversee are necessary, particularly in an increasingly complex financial services environment.

Question 7. If the States fail to act on the NAIC's proposed reforms, and no alternatives are forthcoming from Congress, what would the costs be to the American consumers?

Response 7. We believe the costs would be substantial. For example, our inability to bring new products to market effectively denies consumers innovative new products and services. Competing financial service firms will rapidly occupy this space in the marketplace if we are slow to meet consumer demands, especially in the critical area of retirement security. We are already seeing evidence of diversified firms allocating capital away from insurance and into banking or securities due to the inefficiency of the insurance regulatory system. As firms diversify further, these adverse capital allocation decisions would likely increase. Inefficient regulation also imposes higher costs on insurers, and these costs are in whole or in part passed along to consumers. Companies have squeezed efficiencies out of their own operations, but to date have had little success in moving toward a more efficient and cost-effective regulatory system. Taken together, concerns of this nature could seriously damage the insurance industry and impair the ability of insurers to provide valuable financial and retirement security products to consumers.

Question 8. What are the costs to consumers of State regulation, and why do you believe that national treatment or an optional federal charter might decrease those costs?

Response 8. The unnecessary hard and soft costs associated with the redundancies and inefficiencies of state regulation are enormous. These costs are passed along to consumers. Many believe that only by putting in place a federal charter alternative will the states have sufficient impetus to achieve significant improvements in efficiency (e.g., witness the steps the Conference of State Bank Supervisors has put in place). More generally, many of the major problems of the current system involve doing business in multiple jurisdictions. Having "national treatment" under a state-based system of regulation or a federal charter option with a single federal regulator would achieve (hopefully) the objective the ACLI outlined in response to Question 2: uniform standards; consistent interpretations of those standards; and a single point of contact for dealing with multiple jurisdictions. Matters such as policy form approval and company licensing would not have to be done 50+ times, often pursuant to non-uniform standards and administrative interpretations. By doing these things once on a uniform basis, regulatory protections can be maintained while the huge costs attributable to the duplicative and redundant oversight are substantially reduced.

Question 9. If the current State reform efforts fizzle out, and Congress does not respond with strong federal action, what would the effect be on the long term viability of the insurance industry?

Response 9. As with our answer to Question 7, we believe the consequences would be severe. The marketplace is far less tolerant today of inefficiency than it once was, and market developments are much more rapid. Consumers now demand efficiency, and tools such as the Internet give them enormous ability to seek and find value on a global basis. From a broader perspective, the markets reward efficiency and penalize inefficiency. If insurers cannot become more efficient and cannot respond to market developments quickly, they will risk becoming irrelevant in the dynamic financial services marketplace. The consequences to the economy would be extremely adverse.

Question 10. If Congress were to move forward with an optional federal charter, should we consider an approach similar to NARAB which gives the States a statutory deadline in which to act, with failure meaning the creation of a potentially state-run system with certain Federally imposed standards?

Response 10. The ACLI believes that approaches such as NARAB should be considered as part of the overall effort to make a state-based system of regulation operate more efficiently. Such approaches may at some point prove necessary—or they may not. The concept is certainly one avenue toward "national treatment" within the context of a state-based system of regulation.

Question 11. At what point should Congress start considering an optional federal charter? Aren't the States making significant progress right now towards uniformity without federal interference?

Response 11. As explained in answer to Question 4, many believe that an optional federal charter should exist along side of an efficient state-based system of regulation. The two systems of regulation are complementary, not mutually exclusive. Putting in place a dual charter system for insurance analogous to that found in the commercial banking, thrift, and credit union business is an issue that Congress should seriously consider, and many believe that it is imperative for that consideration to be undertaken immediately.

Question 12. How do you respond to the argument that an optional Federal charter would disadvantage smaller producers that don't want to subject themselves to Federal regulation?

Response 12. Two points are relevant here. First, if a small insurer, perhaps one doing business in a single state, determines that state regulation is more advantageous, that insurer would simply not elect the federal charter option and would remain state regulated. Under a dual charter concept, companies are not forced to become subject to a regulatory scheme they conclude would be disadvantageous. The optional federal charter is just that—an option. Second, for small insurers doing business in multiple jurisdictions, an optional federal charter may be even more beneficial than for larger companies. Small companies do not have the same resources (human and financial) as their larger competitors to get products approved in all jurisdictions. And they do not anticipate the same volume of sales as larger companies out of which they can recoup their capital outlays. Consequently, it is a smaller company doing business in multiple jurisdictions that has much to gain from a federal charter option.

Sincerely,

DRAYTON NABERS, JR.

RESPONSES FOR THE RECORD OF ROBERT MENDELSOHN, CHIEF EXECUTIVE OFFICER, ROYAL AND SUNALLIANCE, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Question 1. How much progress has the NAIC made in the last two months in achieving uniformity, and how much faith should be placed in their efforts?

In March 2000, the NAIC unanimously approved its "Statement of Intent: the Future of Insurance Regulation." Since March, nine NAIC Working Groups have been meeting regularly in an effort to develop a blueprint for needed reforms to the state-based system. This blueprint is expected to be published in December. At that time, AIA will evaluate the progress that has been made, and have a better sense of how much faith should be placed in the NAIC's on-going efforts.

Question 2. What are the minimum results we should insist on from the NAIC effort, and what sort of time-lines can Congress reasonably expect for implementation?

Last spring, the AIA Board of Directors ratified a set of "guiding principles" for regulatory reform. These principles could be achieved in either a state- or a federally-based insurance regulatory system. As such, we believe they are the appropriate standards for assessing the NAIC's blueprint for regulatory reform. The principles are as follows:

- *A Market-based System.* Market forces, rather than regulatory approvals, should dictate the products sold by insurers and the prices they charge—thus, the critical importance of rate and form deregulation. AIA is willing to consider scaling back the McCarran-Ferguson antitrust exemption in exchange for a market-based system that eliminates the type of command and control regulation that has been repealed for so many other industries in the U.S.

- *National Treatment.* Companies should have the option of obtaining a single charter that would allow them to do business in all fifty states. States must be prohibited from discriminating against such companies in favor of those that obtain licensing on a state-by-state basis.
- *Uniform Regulatory Requirements.* Insurance companies that operate in multiple jurisdictions should be subject to one stop, non-duplicative regulation and uniform laws governing market conduct activities, agent licensing, claims practices, solvency, liquidation, and other areas where an on-going regulatory role is in the consumer interest. In these areas, regulations should focus on the issues that really matter to the insurance buying public, and not impose excessive and often meaningless requirements that remain in place long beyond whatever limited benefit they purported to provide at the time they were promulgated.
- *Timely and Impartial Implementation.* Enforcement of regulatory requirements should be timely, impartial, and professional, and fines and other penalties should be proportional to the violation at issue.
- *Level Playing Field.* Insurance companies should be able to operate on a level regulatory playing field vis-a-vis other financial services firms that provide similar products, global competitors, and the alternative market.
- *Technology for the 21st Century.* The regulatory system should embrace the use of new technologies by insurers in every aspect of their business.

AIA recognizes that regulatory reform, whether at the state or federal level, will take some time to implement, but we should expect a blueprint by the end of this year that should include the principles stated above. That blueprint should include meaningful implementation timetables that place responsibility on individual states to improve their systems. Recognizing that this is a long-term project, implementation efforts that include changes to individual state systems should be well underway by mid-2001.

Question 3. What can Congress and the industry do to help the states achieve uniformity?

Within the context of a state-regulated system, federal legislation can help the states achieve uniformity by preempting state requirements that impede effective commerce, such as government price controls; the development of national standards that preempt conflicting state requirements (e.g., the new e-signature law); creation of a single port-of-entry licensing system (e.g., the Risk Retention Act); or a NARAB-type approach. All of these can be done within the context of a system of state regulation, without establishing a system of either mandatory or optional federal regulation. By contrast, national standards that do *not* preempt conflicting state requirements (e.g., Title V of Gramm-Leach-Bliley) do *not* facilitate uniformity.

The insurance industry can help the states to achieve uniformity by either supporting the aforementioned Congressional actions, or by advancing "model" laws or regulations in the states. AIA, for example, was active in the development of the NAIC's new model Gramm-Leach-Bliley privacy regulation, and we will work to achieve its adoption in the states.

Question 4. If states are unable to make progress in implementing uniformity reforms over the next year, what alternatives should Congress consider?

Optional federal chartering, which was discussed at length during the September 19 hearing, is an alternative that would merit serious consideration in this situation.

Question 5. What are the easiest issues for the states to achieve before moving on to the more comprehensive uniformity issues?

As a result of the NARAB provisions of Gramm-Leach-Bliley, states already have a head start on the agent licensing issue.

Question 6. Now that Congress has allowed private-sector financial integration, with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Gramm-Leach-Bliley affirmed the concept of "functional regulation," through which insurance, bank, and securities regulators all maintain regulatory authority over their respective sectors. AIA believes that functional regulation is the only viable approach in a regulatory structure through which some sectors (banks and securities firms) are regulated at the federal level, while insurance remains a state-regulated business. As such, statutory integration should not be considered unless Congress chooses to consider a federal approach, such as optional federal chartering. Gramm-Leach-Bliley does establish a consultative relationship between the federal reserve and state insurance regulators on solvency matters. It is AIA's understanding that a number of discussions among federal functional regulators and the NAIC have occurred.

Question 7. If the states fail to act on the NAIC's proposed reforms, and no alternatives are forthcoming from Congress, what would be the costs to the American consumer?

For AIA members, the ability to bring products to market in a timely and cost-effective manner, along with uniform regulatory treatment regardless of where they are domiciled and where they do business, could determine their survival in the 21st century. But consumers also will suffer if the system is not reformed.

Examples of benefits that will flow to consumers from regulatory reform are as follows:

- Consumers are likely to have more product options;
- Insurance markets will better keep up with fast-paced change in the economy and the financial needs of individuals, businesses and families;
- In those state insurance markets where strict regulation of pricing has kept insurers out of the market, new competitors will enter or re-enter the market.
- Consumers should realize savings in insurance costs as the market becomes more efficient, competitive, and the costs of unnecessary regulation are squeezed out of the system.
- Regulatory reform should also increase the availability of insurance in areas that sometimes experience shortages of carriers willing to provide insurance, including areas subject to natural disasters. Although prices may rise in such areas to adequately cover the true risk, product options like deductibles and discounts for loss mitigation would also increase.
- Regulatory reform will reduce subsidies that lower-risk consumers often provide to those with higher risk characteristics (e.g., high risk drivers).

Question 8. What are rate and form approvals, how do they affect consumers, and how does that regulation differ from other industries?

Property-casualty insurance is one of the nation's last major industries still shackled by heavy regulation of prices and products (rates and forms). All 50 states, the District of Columbia, and the various U.S. territories regulate the insurance industry separately. Pricing of insurance products typically must be submitted, reviewed and approved by state regulators, often even if an insurance company wants to reduce prices. Both routine and innovative new products (insurance policies and endorsements) currently have to be reviewed and approved by dozens of states before they can appear in the marketplace on a nationwide basis. This causes delays in launching these new products and sometimes creates enough roadblocks that new property-casualty insurance products are not launched at all, an indication that the market is not working efficiently for consumers.

Over the past two decades, key American industries--including railroads, airlines, trucking, energy, telephone, banking, and securities--have seen deregulation of pricing, products and entry into new markets. Moreover, for insurers headquartered in other nations that are key U.S. trading partners and competitors in the global marketplace, much less restrictive regulation helps foster innovation and competition.

Question 9. You testified that a streamlined commercial lines regulatory system would bring insurance capital back to the U.S. Can you elaborate on this, and discuss how this might help consumers get better disaster insurance coverage.

The alternative (non-regulated) market for commercial insurance has grown from an estimated 21% in the early 1980s to approximately 35% today. Much of that growth has come in the form of captive insurance companies formed by large U.S. corporations to provide insurance for the company's own property, liability and other related risks. A large majority of captive insurers are domiciled offshore. Bermuda alone accounts for 34% of the total, followed by the Cayman Islands (24.4%), and Guernsey (8.5%). Luxembourg, Barbados, and the Isle of Man are other leading locations for captive insurers, while Vermont is one of the few locations in the U.S. to have a significant concentration of captive insurers. With the exception of Vermont and a few other states with relatively small number of captive insurers, this has meant a flow of insurance capital and jobs away from the U.S.

While companies form captive insurers for several reasons, including tax advantages, freedom from the inflexibility and the complexity of dealing with very different regulatory systems in 50 states, is another important reason. Large, national corporations with multi-state operations and their insurers find it particularly difficult to deal with often slow, complex and non-uniform state-based regulatory systems. Streamlining commercial regulation in the United States would be one factor in helping to keep insurance jobs and capital in the U.S.

Restrictive rate and form regulation in the homeowners' insurance line have led to availability problems in a number of catastrophe-prone states. However, the natural catastrophe problem is a complex issue that is not directly related to commercial lines deregulation.

Question 10. You testified that the need to meet differing regulatory demands in 50 different states increases costs and discourages technological innovation. Can you elaborate on this?

Inflexible state requirements specifying exact data record layouts and formats for electronic transmission of data make it more difficult and less economical for carriers to incorporate new technologies and standards into their information systems. This has been a major challenge for carriers as states move toward electronic filing systems that are not necessarily uniform in layout, format, or data reporting requirements.

Question 11. You testified that the AIA has focused on speed to market for insurance products and national treatment for companies. Why are these the first stepping stones for uniformity, and how will achieving these goals help in reaching more comprehensive uniformity.

Speed to market—the ability to bring products to market in a timely and cost-effective manner—is critical to the insurance industry's ability to serve its customers and to compete with the myriad other risk management alternatives that are available in an environment of increasing globalization and convergence. AIA favors a system where competition in the marketplace, not actions of insurance regulators, determines price and product. A market-based system would provide the greatest possible uniformity because the demands of the marketplace do not stop at state borders, nor do they distinguish between federally- and state-regulated institutions.

AIA also recognizes that there are some issues for which the market may not be an appropriate surrogate for regulation, such as licensing, solvency regulation, market conduct oversight, and so forth. In these areas, national treatment is the goal. The NAIC's National Treatment Working Group is focusing on a single licensing system, but the NAIC leadership recognizes that the broader issue of national treatment involves uniform across-the-board regulatory treatment regardless of where a company is domiciled and it does business.

RESPONSES FOR THE RECORD OF JOHN G. TURNER, VICE CHAIRMAN, ING AMERICAS ON BEHALF OF THE FINANCIAL SERVICES ROUNDTABLE

Question 1. How much progress has the NAIC made in the last two months on achieving uniformity, and how much faith should we be placing in their efforts?

Answer: I am certainly encouraged by the efforts of George Nichols and the NAIC. I think he has done an admirable job of identifying many of the problems in the current state-based regulatory structure. I would add, though, that in light of the extraordinary and rapid changes in the marketplace, reforms have to come soon. Otherwise, insurers will continue to operate at a competitive disadvantage, and will get left behind.

Question 2. What are the minimum results we should insist on from the NAIC effort, and what sort of time-lines can Congress reasonably expect for implementation?

Answer: I would hesitate to impose an arbitrary deadline, but will again say that significant and substantial reform and modernization cannot wait any longer. As you know, Mr. Chairman, no matter how meritorious NAIC model laws and regulations may be, they are non-binding on the states and must be separately proposed and ratified in 51 jurisdictions. Each state is free to modify the model act terms, and often does so. Each such law is then separately interpreted by the insurance department and courts of that state. Achieving uniformity this way is a task likely to take years, if at all.

Question 3. What can Congress and the industry do to help the States achieve uniformity?

Answer: Congress can continue to serve a vital role by holding hearings and gathering information to highlight the problem insurers face in the current system, notably in the areas of licensing, product approval, and privacy. It is my view that the specter of congressional action is a strong and visible incentive for the states to implement long overdue changes.

Question 4. If the States are unable to make progress in implementing uniformity reforms over the next year, what alternatives should Congress consider?

Answer: S. 900 was a great first step in financial modernization. The NARAB provisions contained in that Act serve a useful purpose in promoting uniformity reforms by the NAIC. The Roundtable believes that an optional federal charter would be the most effective way to achieve a seamless and uniform regulatory structure. I cannot overstate the myriad redundancies in a 51 jurisdiction regulatory structure.

Question 5. What are the easiest issues for the States to achieve before moving on to the more comprehensive uniformity issues?

Answer: That question may be better directed to the NAIC, but I will say this: Both industry and the regulators have articulated the problems with the status quo on a number of issues—agent licensing, speed to market, and privacy. I am willing to continue working with the NAIC on constructive solutions to these urgent problems.

Question 6. Now that Congress has allowed private-sector financial integration with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Answer: This is an important question. The umbrella supervision established by S. 900 represents a tremendous advancement in the regulatory structure. There is no question that coordination among the regulators is essential. A streamlined, uniform regulatory matrix would benefit both industry and consumers.

Question 7. If the States fail to act on the NAIC's proposed reforms, and no alternatives areforthcoming from Congress, what would the costs be to American consumers?

Answer: The costs would continue to be significant. Studies have estimated that complying with burdensome, duplicative, and inconsistent rules and regulations in 51 jurisdictions costs consumers hundreds of millions per year. There is no question that increasing uniformity would dramatically reduce these costs.

Question 8. In your testimony, you state that "simply improving the State insurance system . . . may not be sufficient for those insurers that compete . . . on a national level." You also note that you fully support the ongoing efforts of the NAIC to reform the State system. Give us a threshold of what you believe constitutes sufficient reform over the next few years by the States to obviate the need for an optional Federal charter.

Answer: Yes, the Roundtable supports, encourages, and applauds the NAIC's reform efforts. At the same time, we have a healthy skepticism that simply improving the current system will address all of our concerns—or that it can be achieved in a timely manner. Let me offer one striking example which, I think, illustrates the problems insurers face today: It takes an average of 45 days to bring a securities product to market. In stark contrast, it takes 9-18 months for a similar insurance product to reach the consumer. An unlevel playing field forces insurers to operate at a competitive disadvantage relative to other financial services companies and poorly serves the insurance consuming public.

Question 9. If Congress established an optional federal charter for insurers, how would the resulting competition between the federal and state regulators help consumers?

Answer: The Roundtable believes that competition between the regulators would produce better, more effective regulation. For instance, we believe that products would get approved in a much more timely fashion if we had a dual insurance system. Addressing this speed to market problem is vitally important. The dual banking system has been effective in reducing the amount of time it takes for banking products to be approved. We can only assume that a dual insurance system would produce the same efficiencies.

Question 10. Would an optional federal charter work equally well for all lines of insurance, or would it be easier to achieve in certain lines of business?

Answer: The Roundtable believes that an optional federal charter would work equally well for all lines of insurance. We believe increased competition, greater choices and lower costs for consumers, and better regulation would be the hallmarks of an optional federal charter system.

Question 11. If the current state efforts begin to falter, should Congress consider a NARAB type approach which would give the States a certain period of time to achieve key goals, with failure to do so resulting in the creation of Federally imposed nationwide treatment run by the States with Federal involvement as a backstop if the States refuse to comply?

Answer: NARAB was a positive development. But I am not sure that we have the time to consider another NARAB type approach. The marketplace is not going to wait for insurers who have to play catch up due to a non-uniform, multi-state regulatory structure. Remaining at a competitive disadvantage is no longer an option.

Question 12. Can you explain the difference between "politicized pricing" and "risk based pricing" of insurance products?

Answer: Risk based pricing, unlike politicized pricing, is competitively determined and takes into account the actual risks involved. As Congressman Shimkus pointed out, Illinois has a market-based system for determining insurance prices and products that would serve as a useful model in the development of a new federal system. Experience has shown that reliance on the market is the best way to give consumers good insurance products at fair prices that reflect the risks involved.

Question 13. You testified that many State insurance departments do not have the same quality or quantity of staff resources that a federal regulator would have. If an optional Federal charter were created, wouldn't that deplete the resources of those State Departments even more, or could the states then group together into a state-run centralized system?

Answer: I believe that an optional federal charter would make state regulation more effective. Competitive choices promote and enhance innovation, efficiency and quality in governmental performance—benefiting the regulated entity but more importantly, the consumer. A dual-federal state system produces a creative and productive tension that tends to improve the quality of regulation and the business options available to the private sector. Indeed, the NAIC's SR2000 initiative itself suggests the merits of a dual system, because it clearly responds to the movement among insurance companies to develop a federal charter option. Ending the state monopoly in insurance regulation will strengthen the entire system and our economy.

RESPONSES FOR THE RECORD OF PHILIP H. URBAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER GRANGE INSURANCE COMPANIES ON BEHALF OF THE ALLIANCE OF AMERICAN INSURERS

Question 1. How much progress has the NAIC made in the last two months on achieving uniformity, and how much faith should we be placing in their efforts?

Response. In the past two months, the NAIC has adopted a privacy regulation and made changes to its producer licensing model act. The regulators also have moved closer to defining more uniform standards for company licensing and rate and form filings. The NAIC has made some progress, but it is too early to be able to fully evaluate their proposals. There is, however, concern that state insurance regulators are not moving toward a market-based regulatory approach. If modernization of state insurance regulation is to be a success for all parties, that needs to be the case. In the final analysis, state legislatures will appropriately play a key role in the improvement of state regulation.

Question 2. What are the minimum results we should insist on from the NAIC effort, and what sort of time-lines can Congress reasonably expect for implementation?

Response. In terms of minimum results, the complexity of insurance regulation precludes an easy answer. Given the fact that the states are sovereign, the process for improving and modernizing state regulation will necessarily take some time. The process can be facilitated by the NAIC if it does good work in developing model laws and in giving guidance to the states in their operations.

In relation to the property and casualty industry, because of different tort law and other local factors that affect rates, forms, and claims handling, such as weather, catastrophe exposure, population density and traffic congestion, we should not seek to achieve a one-size-fits-all uniformity. In the areas of producer licensing, company admissions to do business in a state, privacy requirements and various other aspects of insurance regulation, more uniformity would be preferable. The timeline for uniformity in producer licensing has been set by Congress with respect to the provisions in the Gramm-Leach-Bliley Act (GLBA) that creates the National Association of Registered Agents and Brokers (NARAB). The Accelerated License Evaluation Review Techniques (ALERT) program concerning admissions to do business in a state is under rollout. How the states will approach privacy regulation for insurance companies is an open question. The National Conference of Insurance Legislators (NCOIL) is considering its own model law.

One area that needs improvement by the states in order to address the need for a more competitive marketplace is the reform of state rate and form regulation. The property and casualty industry has urged the NAIC to consider improvements in the way those filings are handled today. Those improvements would not require changes in state law and thus could be accomplished with relative speed.

In addition to the regulatory structures and processes, states need to concentrate on the culture of regulation. We do not believe that a bad regulatory culture will produce a better result because it is in a different structure. We think it is premature to put a precise timetable on these improvements. We believe Congress should periodically seek input from the industry to determine if reasonable progress is being made at the NAIC.

Question 3. What can Congress and the industry do to help the States achieve uniformity?

Response. The interest that Congress has shown in state insurance regulation is healthy. It is partly responsible for the energy and focus now seen at the NAIC on the issue of modernizing insurance regulation. More time is needed in the process at the NAIC and in the states to see what can be achieved. It is our conclusion at this time that there is not any clear litmus test that will indicate a clear failure of state regulation.

Question 4. If the States are unable to make progress in implementing uniformity reforms over the next year, what alternatives should Congress consider?

Response. As indicated in the answer to question #3, it is too early to consider any litmus test and therefore too early to consider alternatives that should be put before the Congress.

Question 5. What are the easiest issues for the States to achieve before moving on to the more comprehensive uniformity issues?

Response. States should first satisfy the GLBA requirements (producer licensing and privacy), and then work on reforms to rate and form filings, company licensing and market conduct examinations.

Question 6. Now that Congress has allowed private-sector financial integration with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Response. The NAIC has taken the initiative to reach out to federal regulators and determine what is required in the way of integration. Four of the nine task forces created by the NAIC are working on issues of coordination of regulation under GLBA. We understand from NAIC reports and representations from individual insurance commissioners that there is a lot of exchange of information and conversation taking place between the state and federal regulators.

One critical area for coordination would be solvency regulation. It will be important to preserve the separation of accounts and funds of the affiliated financial entities. Fraud investigation and prevention as well as protecting consumers from improper practices such as tying are other critical areas for coordination.

Question 7. If the States fail to act on the NAIC's proposed reforms, and no alternatives are forthcoming from Congress, what would the costs be to the American consumers?

Response. We do not know how to answer the question on costs to American consumers. There is a benefit to consumers from state regulation, which has worked well. State regulation has helped create a competitive marketplace. It responds to local needs. It is close to the consumer. It is our belief that state regulation can work well in the future.

Proposals for federal regulation or a greater role for the NAIC also have a price tag. These proposals will need to be weighed against issues such as costs in dollars, benefits of political and fiscal accountability in state regulation and more.

Question 8. Mr. Smith testified that our current state system for rate filing is "inefficient, paper intensive, time-consuming, arbitrary, and inconsistent with the advance of technology and the regulatory reforms made in other industries." Would you agree with this statement, and how does this affect consumers?

Response. As a businessman, I believe that any type of regulation, be it at the federal, state, or local level, can be classified in the burdensome terms used by Mr. Smith to describe the current state-based insurance regulatory system. They are broad terms that are used to describe practically every kind of regulation, and in my opinion should not be reserved only for state insurance regulation.

With that said, there are clearly faults in the rate filing process. That is why a market-based system of rate-setting is preferable to cumbersome prior approval processes. In Illinois, as I mentioned in my testimony, the 30-year experience with competitive rating without regulatory intervention has proved a great success.

As mentioned in the response to question #2, it is just as important for states to concentrate on the culture of regulation as it is on regulatory structures. A bad or deficient regulatory culture will not produce a better result simply because it is part of a different structure. The Department of Housing and Urban Development (HUD) venturing into insurance regulation with total disregard for actuarial and underwriting principles is a clear example. We would consider that type of federal regulation to fit all of the criticisms that Mr. Smith leveled at the current system for rate filings in the states.

Question 9. If we want to forestall an optional federal charter, how can we encourage the States to adopt more uniform regulations, and how can industry best assist these efforts?

Response. Perhaps the best way to forestall an optional federal charter is to involve state legislative organizations in this debate. To that end, the insurance industry already has been actively involved with NCOIL and with the National Conference of State Legislators (NCSL). Overtures also need to be made with the National Governor's Association (NGA).

Question 10. You testified that progress towards uniformity in key areas may require legislative enactments by State legislatures, which you suggested would be difficult. How can we make sure that the State legislators are included in this process and support uniformity efforts?

Response. As the answer to the previous question suggests, Congress and the industry need to fully engage state legislators in this debate so they understand the desirability of taking action to reform state-based insurance regulation. In the final analysis, state legislators will determine the scope and shape of the modernization of state insurance regulation.

Question 11. If the States can ensure a non-discriminatory system, which issues should be the first candidates for national treatment?

Response. For the property and casualty industry, the areas of regulation that deal with rates, forms, underwriting and claims reflect true local market conditions and are not necessarily candidates for uniformity. They are, however, candidates for improved regulatory practices and procedures. On the other hand, the areas of access to markets such as licensing a company, licensing an agent and various corporate matters, standards for electronic commerce and privacy are probably best treated uniformly.

But the question as to candidates for "National Treatment" begs the questions of what kind of National Treatment, possible redundant regulation or expense, and costs vs. benefits. However, Congress has already determined that producer licensing should be the subject of uniformity or reciprocity.

Question 12. You testified that the NAIC's privacy models "do not meet the overall policy goal of equal treatment for all market participants." Can you elaborate on this, and suggest how equal treatment can be achieved?

Response. The NAIC privacy regulation contains a health information privacy provision that goes beyond the financial privacy regulation promulgated by federal regulators for the banking industry as well as the provisions of GLBA. As a result, insurers will be put at a potential marketing disadvantage, and the different disclosure notices they will receive from the different financial institutions will confuse consumers.

Question 13. What do you believe should constitute the minimum level of acceptable implementation of uniformity within the next year?

Response. The level of complexity and the fact that the discussion at the NAIC has just gotten to the solution stage would make it premature to determine what should happen within a year. Additionally, as I indicated, uniformity in and of itself is not necessarily appropriate as to all aspects of property and casualty insurance regulation. Finally, the costs and benefits of any regulatory scheme have to be considered together. The values of state regulation have to be measured against some potential inefficiencies. As improvements and modernization in state regulation are achieved, the picture will become clearer as to what is an "acceptable" level of implementation of regulatory modernization in the states.

Some standards are more clear than others. A majority of states (29) should adopt the reciprocity option described in the NARAB requirement under GLBA. All states should adopt a privacy regulation. All states should make a commitment to implement the uniform company licensing application and a uniform company licensing process. Regulators also should agree to work toward rate and form filing reforms, although if any changes necessitate legislative action, that could take several years.

INDEPENDENT INSURANCE AGENTS OF AMERICA
October 2, 2000

The Honorable THOMAS J. BLILEY
Chairman, Committee on Commerce
United States House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515-6115

DEAR CHAIRMAN BLILEY: Thank you for your letter dated September 22, 2000. I was honored to testify recently before the Subcommittee on Finance and Hazardous Materials, and I appreciate the leadership that you and Chairman Oxley have exhibited in the area of insurance reform. The Independent Insurance Agents of America (IIAA) recognizes your dedication on this front, and we look forward to continuing to work with you in the future. Per your request, I have also responded to your written questions, and each is addressed on the pages that follow.

Please feel free to call upon me or the IIAA if we can be of any additional assistance. We are prepared to assist you in any way you deem appropriate.

Very truly yours,

RONALD A. SMITH
Past President, IIAA

cc: The Honorable Mike Oxley
Chairman, Subcommittee on Finance and Hazardous Materials

Question 1. How much progress has the NAIC made in the last two months on achieving uniformity, and how much faith should we be placing in their efforts?

Response. Over the last several months, the National Association of Insurance Commissioners (NAIC) has aggressively considered and debated how the current regulatory regime might be modified and improved. This effort began with the adoption of the "Statement of Intent," a document which outlines a framework of principles through which the country's insurance regulators have begun to address the challenges and opportunities confronting state regulation. The statement is essentially a blueprint of issue-specific goals that the NAIC intends to tackle in the immediate future. These objectives relate to issues that must be addressed quickly, such as the implementation of the Gramm-Leach-Bliley Act (GLBA), and those issues that will take longer to resolve, such as the state response to globalization, the emergence of technology, and the call for reform of the current regulatory system.

Question 2. What are the minimum results we should insist on from the NAIC effort, and what sort of time-lines can Congress reasonably expect for implementation?

Response. In a recent white paper, the NAIC stated the following:

> "While some may argue that regulation dampens competition or promotes the interests of one particular interest group over another, insurance regulation represents a series of compromises between competing interest groups. Some insurance regulation is decidedly pro-consumer, while other facets of insurance regulation may be characterized as pro-insurer or pro-third party. The business of insurance regulation must involve a continuous rebalancing of benefits to competing interest groups. To the extent that regulators are successful in their balancing efforts, a vigorously competitive marketplace can co-exist with reasonable controls designed to protect consumers and other parties to insurance transactions."

As the NAIC suggests, the appropriate barometer for measuring whether the States are effectively regulating the industry is whether (1) the insurance marketplace is competitive, and (2) whether consumers are adequately informed, protected, and represented. We believe this is the fairest and most appropriate criteria for judging State reform efforts. We have already seen significant progress in recent months, and we expect more of the same in the weeks and months to come.

Question 3. What can Congress and the industry do to help the States achieve uniformity?

Response. One way in which Congress can help the States achieve agent licensing uniformity is by providing insurance regulators with limited and well-defined access to the National Crime Information Center (NCIC) database. I know your committee is already discussing this possibility, and we believe that regulator access could promote both uniformity and consumer protection.

Given the sensitivity of the information contained in the NCIC database, however, any grant of access must be thoughtfully considered and properly constructed. This issue raises serious privacy concerns, and the proper balance must be obtained. IIAA, in conjunction with several other insurance industry associations, has already developed a proposal that would provide insurance regulators with access to the database so regulators can effectively and proactively perform their licensing responsibilities. The proposal would also provide limited access for employers who wish to perform personnel checks on employees or potential employees. In our view, there is no public policy justification for providing unlimited and unqualified access to these files to anyone that might request them.

Question 4. If the States are unable to make progress in implementing uniformity reforms over the next year, what alternatives should Congress consider?

Response. Even before the NAIC outlined its "Statement of Intent" agenda, the States were successfully revising insurance regulation in numerous ways. Over the last couple of years, many states have eliminated discriminatory barriers to interstate commerce, made it easier to bring insurance products to market, and provided numerous other regulatory reforms. The States also proved that they were up to the challenge of regulating e-commerce, and nearly one-half of the States enacted the Uniform Electronic Transactions Act (UETA) in the single legislative session since its adoption by the National Conference of Commissioners on Uniform State Laws. In fact, the recently enacted Electronic Signatures in Global and National Commerce Act was, in large part, based on this state-developed solution.

These steps, combined with the NAIC's recent actions, suggest to us that the current system can work. For this reason, we believe it is premature to be considering alternatives to the current state regulatory system.

Question 5. What are the easiest issues for the States to achieve before moving on to the more comprehensive uniformity issues?

Response. This is a difficult question to answer. The States have already begun to address the reform issues that are easy to address and are now shifting their focus to tougher challenges. Although insurance reform will not be an easy task, it is apparent that State policymakers are committed to tackling the challenges ahead.

Question 6. Now that Congress has allowed private-sector financial integration with the enactment of the Gramm-Leach-Bliley Act, what should we do to integrate the financial regulators, and what are the most critical areas that should be coordinated?

Response. We are watching with great interest how the various financial regulators will work cooperatively in the weeks, months, and years to come. On the insurance side, the NAIC and individual state regulators have begun to work closely with their counterparts in a variety of ways, and we have been generally satisfied to date with how this has worked.

We are very concerned, however, by certain actions taken by the Office of the Comptroller of the Currency (OCC). In three separate instances, the OCC has been asked by banking industry groups to toss aside state level insurance sales consumer protections. Specifically, these groups have asked the OCC to preempt consumer protections previously enacted in Massachusetts, Rhode Island, and West Virginia. An ill-advised OCC preemption opinion issued in response to these requests could disrupt regulatory activities in the more than 30 states that have substantively identical insurance sales protection provisions in place. This is especially troubling because—virtually without exception—these consumer protections were enacted with the support of consumer advocates as well as both the banking and insurance industries in each state.

Our concerns with the OCC's recent actions are further outlined in my written testimony. I should note again, however, that it would undermine efforts to achieve regulatory coordination if this federal agency begins to preempt state consumer protection laws. We also fail to see how that would serve the American public in any way.

Question 7. If the States fail to act on the NAIC's proposed reforms, and no alternatives are forthcoming from Congress, what would the costs be to the American consumers?

Response. As noted in my responses to these questions and in my formal written testimony, we believe the States have taken considerable steps in recent months to achieve regulatory reform. We expect that the States will continue to act upon meaningful reforms, provided the proposals are truly in the best interests on consumers.

Question 8. You testified that your members are frustrated because "they are trapped in a licensing system full of antiquated, duplicative, unnecessary, and protectionist requirements." Can you elaborate on that, and discuss how the Gramm-Leach-Bliley Act might help address some of those frustrations?

Response. One of the most important responsibilities facing state regulators of insurance is the duty to properly license agents to conduct the business of insurance within a given state.

Advances and changes in the marketplace have led increasing numbers of agents and brokers to operate in multiple states, which means that they must obtain more and more licenses. For example, my agency is a relatively small one, yet we are licensed in over a dozen states. It can be difficult and confusing to stay on top of the required paperwork and to clear the logistical and bureaucratic hurdles that are in place today. Staying in compliance with the distinct and often idiosyncratic agent licensing laws of every state is no easy task. It is an expensive, time-consuming, and maddening effort for many agencies, and a dedicated staff person and tremendous financial resources are often required to manage an agency's compliance efforts. These opportunity costs and wasted man-hours could be better spent working on behalf of our customers.

Conflicts and differences between States over continuing education, licensing, and paperwork requirements have created an entire new industry dedicated to helping agents decipher and comply with the layers of complex regulations. In essence, the problems associated with the current system can be divided into three main categories: (1) the disparate treatment that nonresidents receive in some states; (2) the lack of standardization, reciprocity, and uniformity; and (3) the bureaucracy generally associated with agent licensing.

However, the NARAB provisions contained in the Gramm-Leach-Bliley Act ensure that these three problem areas will be addressed soon—either by the automatic implementation of the provisions themselves or by the enactment of preemptory reforms at the state level.

Question 9. If the States are unable to make significant progress towards uniformity on speed-to-market and national treatment, could Congress consider another NARAB approach to help encourage the process?

Response. This is a difficult question to address at this time. We believe the States should have an adequate opportunity to address these issues. If the NAIC and the States are forced to move too hastily, it may result in recommendations and solutions that are not in the best interest of consumers.

Question 10. How can the National Insurance Producer Registry be used to help the NAIC coordinate their efforts with the securities and banking regulators and combat fraud?

Response. It is our understanding that the NAIC and individual states are today working closely with other functional regulators to combat fraud, and we encourage these efforts. However, the National Insurance Producer Registry (NIPR) only addresses producer licensing and producer appointments, so its impact on fraud prevention is naturally limited. Other industry players generate far more consumer complaints and are the subjects of greater numbers of enforcement actions, and any public policy effort to address fraud must be considered with this fact in mind. Individual states and the NAIC apparently maintain databases with this type of complaint information, but we are unaware of any plans to share this information with other regulators or to make it public.

NIPR, however, does have the potential to drastically improve the manner in which agents and brokers obtain licenses. We are very pleased by the progress that this effort has made in recent months, and we are particularly happy to report that NIPR is in the process of becoming compliant with the Fair Credit Reporting Act.

My written testimony also describes the producer community's efforts to reconstitute the makeup of NIPR's Board of Directors. As noted above, NIPR's mission is limited solely to agent and broker licensing and appointment issues, yet producers have only one representative on the Board. In contrast, there are three insurer representatives on the Board.

Given the importance of NIPR's mission to the agent and broker community, we have proposed that the makeup of the Board be reconsidered. Specifically, we have proposed adding two new producer representatives to the board (thus establishing parity between the insurer and producer communities) and adding two additional regulator representatives (thus preserving the balance between the private and public sectors). While we commend NIPR for opening its meetings to an expanded audience, we believe the reconstitution of the Board is critical. The decisions of the Board directly impact the agent and broker community, and we believe that perspective should have an equal voice in the development of NIPR policies and services.

Question 11. How can we best conduct uniform background checks on agents to combat fraud, and what issues do we need to be concerned about?

Response. Any public policy response to insurance fraud should not be limited to or focused on insurance agents. Most complaints received by state insurance departments are in fact generated by consumers following encounters or experiences with insurers or their employees. While it is essential that the industry work to identify and remove rogue agents from the system, it is important to recognize that agents are not the cause nor the subject of most consumer complaints.

One way to facilitate the effective use of background checks would be to provide insurance regulators with limited and well-defined access to the National Crime Information Center (NCIC) database, a possibility which your committee is apparently already considering. At the same time, we strongly believe that any grant of access to the NCIC database must be thoughtfully considered and properly constructed. This issue raises serious privacy concerns, and the proper balance must be obtained. As you know, IIAA (in conjunction with other industry trade organizations) has already developed a proposal that would provide insurance regulators with access to the database so regulators can effectively and proactively perform their licensing responsibilities. Our Washington representatives are prepared to work with you and your committee on this issue and to address it thoughtfully and with due consideration.

Question 12. How much progress has the NAIC made on establishing uniformity for insurance agent licensing, and what are the lessons to be drawn from this effort that could be applied to other uniformity efforts?

Response. We commend the NAIC for its efforts to reform the agent licensing process, forestall the creation of NARAB, and strengthen state regulation. Our members know firsthand the burdens, costs, and bureaucracy associated with the current system, and they look forward to realizing the promise of a reciprocal and more uniform multi-state licensing system. It is also our hope that reform of the agent licensing system will preserve state regulation—without reducing consumer protection or creating competitive disadvantages for certain insurance providers.

The licensing of insurance producers is a critical component of state regulation. Licensing statutes impose minimum eligibility and consumer protection requirements to ensure that a licensed individual or firm is qualified for the activities in which they are engaging. Laws regulating the licensing of insurance producers protect the insurer/insured relationship by attempting to ensure that prospective policyholders obtain reliable insurance that is adequate for their needs. As the United States Supreme Court has recognized, licensing laws embody a

> *series of regulations designed and reasonably adapted to protect the public from fraud, misrepresentation, incompetence and sharp practice which falls short of minimum standards of decency in the selling of insurance by personal solicitation and salesmanship. That such dangers may exist, may even be widely prevalent in the absence of such controls, is a matter of common knowledge and experience.*

Licensing laws are therefore designed to increase the likelihood that insurance purchasers will obtain from qualified persons products that best meet their needs—and that the insurance they purchase will be reliable and appropriate for their purposes. Demonstrating competence to sell insurance products and being subject to an appropriate set of consumer protection requirements and state enforcement mechanisms are still absolute necessities. The licensing process constitutes the primary mechanism by which regulators can stop unscrupulous actors and intervene to protect the public. Without licensing, there is little practical way for states to effectively supervise and regulate the qualifications and actions of insurance providers.

The NAIC's primary response to the Gramm-Leach-Bliley Act and answer for agent licensing reform is the Producer Licensing Model Act, a model law that attempts to achieve a number of goals. Perhaps most significantly, the model provides the level of licensing reciprocity required for a state to become "NARAB compliant." While most of the model's provisions do not affect a state's ability to satisfy the NARAB requirements, many of them bring greater uniformity to the multi-state licensing process. Our members generally support the model's core reciprocity and uniformity provisions, and we believe the adoption of these provisions will simplify and streamline the licensing process and make the creation of NARAB unnecessary.

One of the issues unrelated to NARAB compliance that is addressed by the model is the "scope of licensure" issue. The act purportedly requires a person to be licensed if he/she performs any of three defined activities or functions—selling, soliciting, or negotiating insurance. While it might appear at first blush that the model requires anyone selling, soliciting, or negotiating to be licensed, one must also consider the model's licensing exemptions. An individual or entity satisfying one of the exemptions need not be licensed. Throughout the development of the model law, we consistently pointed out our concerns with the model's licensing definitions and exemptions and proposed numerous alternatives. The NAIC, however, chose not to address these issues during the model's initial development.

Despite the model's ambiguous and imprecise drafting, it is clear that the regulators who drafted the model intended to prohibit unlicensed individuals from engaging in insurance sales or solicitations and from providing advice, counsel, or recommendations to consumers—regardless of whether the consumer is a new or existing customer. In fact, the Co-Chairman of the NAIC Agent Licensing Working Group described the intent by saying that the model was not meant to authorize unlicensed individuals "to sell, solicit or negotiate other insurance or additional coverage or provide quotes for expanded coverage on an existing policy." We believe this is the proper public policy. In our view, existing policyholders should be secure in knowing that individuals offering advice or recommendations are as qualified, competent, and accountable as those who would offer the same services to a new customer. While we take comfort in the fact that the NAIC appears to agree with us on the underlying policy question, we are concerned that the intent of the model law is not adequately expressed in its text.

Given growing concerns about the model's ambiguity on the "scope of licensure" issue, we have asked the NAIC to revise the act to make clear that unlicensed individuals may not legally solicit the sale of insurance, offer advice or recommendations, cross-sell products, or otherwise act in the capacity of someone who should be licensed—regardless of whether these activities occur in connection with an existing policy. We have urged the NAIC to help eliminate the potential for conflicting interpretations, avoid the need for judicial interference, and most importantly, protect insurance consumers. The adoption of appropriate clarifications would greatly enhance the model's prospects for passage in a uniform manner nationally, and none of the suggestions being considered alters or conflicts with the intent of the regulators involved in the drafting process.

To its credit, the NAIC's NARAB Working Group recently took action on this issue and unanimously recommended that Section 4(b)(8) be deleted from the model. This was one of the clarifying suggestions that we offered to the NAIC, and we are pleased that it was adopted so overwhelmingly by the committee with jurisdiction over such issues. The NAIC's Executive Committee and Plenary body are scheduled to consider the deletion of this unnecessary provision on October 4, and we are hopeful that the regulators will approve this clarification. We believe this is the proper public policy position, and it is consistent with the NAIC's stated intent. If this modest step is not taken, the NAIC will be making a serious misjudgment that threatens its efforts to obtain licensing uniformity and forestall the creation of NARAB.

During its recent consideration of these issues, the NAIC's NARAB Working Group also developed a series of guidelines that outline the intent of the regulators in addressing the scope of licensure issue. A copy of these guidelines is attached for your review.

The NAIC has the opportunity to prove that the states can modernize state regulation while also protecting consumers and preserving the high standards of licensure. We hope the NAIC will grasp this opportunity and prove that these objectives are not mutually exclusive. The NAIC has said that the primary goal of its reform agenda is to protect consumers proactively and aggressively. Clarifying the model's "scope of licensure" provisions is consistent with this overarching principle, and we continue to encourage them to do so.

NATIONAL GOVERNORS' ASSOCIATION

Parris N. Glendening
Governor of Maryland
Chairman

John Engler
Governor of Michigan
Vice Chairman

Raymond C. Scheppach
Executive Director

Hall of the States
444 North Capitol Street
Washington, D.C. 20001-1512
Telephone (202) 624-5300
http://www.nga.org

September 19, 2000

The Honorable Michael G. Oxley
Chairman
Subcommittee on Finance and
Hazardous Materials
House Commerce Committee
2125 House Rayburn Office Building
Washington, D.C. 20515

The Honorable Eldophus Towns
Ranking Member
Subcommittee on Finance and
Hazardous Materials
House Commerce Committee
2232 House Rayburn Office Building
Washington, D.C. 20515

Dear Chairman Oxley and Ranking Member Towns:

Earlier today, the House Commerce Subcommittee on Finance and Hazardous Materials considered the topic of "Improving Insurance for Consumers -- Increasing Uniformity and Efficiency in Insurance Regulation." The National Governors Association (NGA) would like to make you aware of the text of a resolution on this topic that was adopted at the 2000 NGA Annual Meeting. The resolution is as follows:

> "The world's financial markets are undergoing rapid changes, driven by the convergence of different sectors of the financial services industry, technological advances, and globalization. The regulation of insurance, which is conducted at the state level, needs to be responsive to these changes to ensure the continued competitiveness of our nation's financial institutions in a global marketplace and availability of quality insurance products and services to American consumers. The Governors accordingly seek to work with the state insurance regulators, the insurance industry, and consumers to promote uniformity and to streamline the insurance regulatory process in an efficient. market-oriented approach that will be beneficial to both industry and consumers."

At your discretion, NGA invites you to include this letter as part of the public record on this topic.

Thank you for considering our views.

Sincerely,

Governor Mike Johanns
Chair
Committee on Economic Development
and Commerce

Governor Don Siegelman
Vice Chair
Committee on Economic Development
and Commerce

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