Testimony of Jaxon A. White, Chairman & CEO
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Good afternoon Chairman Baker, Ranking Minority Member Kanjorski and other members of the Subcommittee. I'm Jaxon White, the Chairman and Chief Executive Officer of the Medmarc Insurance Group. I appreciate the invitation to appear before the Subcommittee and offer my views on efforts to reform state insurance regulation.

The Medmarc Insurance Group has been in business for 24 years and I have served as the chief executive officer for the last 19 years. The Group consists of three property and casualty insurance companies. In the business structure, the top organization is a mutual insurance company which then owns two stock insurance companies. The mutual company and one subsidiary are domiciled in a single state and the other stock company has a different state of domicile.

My goal for this appearance is twofold. First, I wish to thank the Members for exploring the possible role of the Federal government in the regulation of insurance among the states. My second purpose is to assist the Subcommittee by making certain points about the challenges of state by state regulation from the perspective of a small insurance company.

Medmarc is a small insurer by most assessments. In 2003, net premiums written will be $75.0 million. We have a staff of 60 persons and offer products liability insurance coverage to manufacturers and distributors of medical technology. Our customers are also our owners since we are a mutually owned and controlled group. Our customers, both current and prospective policyholders, are based in all 50 states and the District of Columbia. To effectively reach and serve these customers, we do business through the two stock insurance companies – one for admitted coverage and one for non-admitted coverage. A non-admitted insurer is also commonly referred to as a surplus lines carrier. Both companies have licenses or authority to operate in 50 states. As such, we are obliged to comply with licensing, reporting and filing for 100 rights to do business.

We support state regulation of insurance but believe it should become more rational to accommodate and sustain small insurance companies. It may interest the Committee to know that we have no competitors of similar size. Our competitors are very large insurers with much different economies of scale in dealing with state regulators and their varying requirements. That is not to say that state regulation is any better or different for big insurance companies but they do have more resources to cope with the problem, in my opinion. One solution to the problem for large and small insurers, alike, may be Federal standards. Done effectively, Federal standards would promote common interpretations of compliance, licensing and other key parts of the state regulatory system. At this juncture, it is not my objective to suggest a specific course of action. However, is seems possible that some manner of Federal pre-emption may be needed to move state legislatures and state insurance departments toward a baseline for reform. In the following comments, I would like to illustrate some of the problems with inconsistent regulatory practices and rules that lend themselves to reforms aimed at consistent interpretation and treatments from state-to-state.

Insurance Company Licensing

The foundation of the state regulatory system is licensing of insurance companies. I am certainly willing to acknowledge beginning steps taken by the NAIC to encourage uniform company license applications in recent years. Regardless, our experience may be instructive as to how company licensing is a competitive barrier to entry for a small insurance company. Prior to 1995, we conducted business as a reinsurance company under a business arrangement with a large insurer. Operating as a reinsurer, our minimum legal requirement was a license in just one state. The large insurer, licensed in all states, issued coverage and our company reinsured most of the loss exposure. The agreement was vital to the growth of our company while we accumulated sufficient capital and experience to reach a threshold for licensing. As we contemplated our options in the three years before 1995, it was clear that we could not become a licensed company in all states within any less than **five** years and probably longer. The company licensing process in 1995 was insurmountable for a small insurance company that had to have approvals in all 50 states. We turned to a pragmatic and expensive solution. We bought an admitted insurance company corporate shell that had licenses in 47 states. The transaction cost was $3.6 million and it consumed just under ten percent of our policyholder surplus. The decision to purchase the shell insurance company was the right course of action for that time period and I do not regret the choice. It gave our Company a means of business independence because we could begin to issue insurance coverage in most states. The migration of our policyholders from the old, dependent, arrangement to the independent arrangement took three years.

In retrospect, we were not looking for special treatment just because of the Company's small size. Nevertheless, we could not possibly enter the national marketplace as a licensed insurer in 1995, or even today, under the patchwork of company licensing requirements and do it <u>within the span of a year</u>. Taking more time than a year, in our situation, would mean the loss of business to others who already had licenses. In business, you do what you have to do to protect your financial interests from threats or barriers. In the case of state insurance company licensing, it seems fundamental and compelling to level the playing field for all companies willing to compete – regardless of size. Our story might illustrate an occasion when Federal standards for insurance company licensing would have provided a gateway for a small insurance company that otherwise had the impossible task to meet disparate rules and protracted delays for licensing in state after state.

Filing and Approval of Policy Forms

I don't wish to belabor this story but it does have another installment. After acquiring the admitted insurance company in 1995, we faced a range of new hurdles in the vast differences among state regulatory systems. We encountered problems with the next step in the process; the approval of policy forms. Among other filing obstacles, a key issue for us was a barrier in some states disallowing a desirable policy form known in the industry as claims-made coverage.

Coverage under the claims-made policy form allows a small or a large insurer to price coverage for the expected loss experience but only for claims that are reported to the insurance company during the policy period. Some states do not allow insurers to write this coverage form but there is no sound basis for this decision, in our opinion. As a practical effect, we cannot offer the claims-made policy form in one state while it is permitted in a neighboring state.

We coped with the policy form barrier for several years by offering different coverage forms in different states. The predictable outcome of varying the coverage form is complexity in setting rates and uncertainty in striving for an annual underwriting profit. I am not suggesting that our business was imperiled but it was more expensive to operate and profit-planning became more difficult. Faced with these business challenges, we decided to purchase another shell insurance company with approvals in 48 states to write business as a surplus lines or non-admitted insurer. The price tag for this corporate shell was $3.5 million. That is a small number for a large insurer but another large cost to a small insurance organization.

The surplus lines company was acquired in 2001 and it was an immediate road to a business solution but not a lower cost of doing business. Policy forms and rates used by a surplus lines insurer are historically insulated from filing and approval requirements in all states. The primary reason for purchasing the surplus lines company was a certain freedom from large differences in policy form regulation from state-to-state. We did not purchase the shell to avoid constructive state regulation. We did purchase the company to bring more uniformity to coverage offerings. In our view, the accident of a policyholders' business location in one state versus another state should not be a barrier to purchasing commercial property or casualty insurance that is desired by the customer rather than dictated by regulatory practices.

There are many subtleties that can be debated between the merits of admitted coverage versus surplus lines coverage. However, my purpose in telling our story is focused on the big picture. Perhaps the following question is worthy of reflection in the future discussion of Federal regulatory standards. Is it useful or productive for a small insurance company to spend millions of dollars to acquire the rights to offer insurance coverage with some degree of uniformity? Again, I don't have a quarrel with state sovereignty but it just seems that Federal standards could create a more conducive regulatory climate and allow a small insurer to compete more effectively in the market.

Market Conduct Examination

Another area of focus is market conduct examinations and the need for much better application and interpretation of rules. This area cries out for consistency for a small insurance company. At the outset, I wish to state that our companies are very serious about compliance with market conduct. The problem we encounter is how to properly anticipate the correctness of our actions from state to state. I am not suggesting that we should have a national playbook on how to build a satisfactory program for market conduct. On the other hand, we do need a much better picture of market conduct priorities within all state insurance departments. The consumer protection purposes of market conduct examinations are not disputed by any insurer. The problem arises when consumer protection becomes a big curtain to hide many unsuspecting pitfalls from a small insurer.

In our limited experiences with market conduct, we know that mistakes have been made, observed by the examiners and corrected to their satisfaction. Nevertheless, the market conduct process is intimidating for a small insurer because we don't know how a particular state will interpret rules or find infractions that would be immaterial in the practices of another state insurance department. As I noted earlier, we market and sell a tailored insurance product for a target audience. The appeal of our Company to the insurance brokers and policyholders is flexibility in coverage terms and associated pricing. If market conduct compliance was our overriding business objective, we could simply offer approved forms and follow loss cost data published by the Insurance Services Office, of which we are a member. But our dominant business objective is meeting the needs of our customers. To achieve this goal, we frequently vary policy terms, conditions and pricing to satisfy the wants and needs of the customer. The trouble arises when there is an overlay of business uncertainty about whether our underwriting decisions and processes will run afoul of market conduct compliance notions.

The choice between market compliance and meeting the customer's needs is not black or white. Our insurance companies want to satisfy the requirements of law and regulation in every state where we do business. The current environment for market conduct variability among the states does not lend itself to an acceptable degree of certainty in operating a small insurance company business. Some observers in the industry have suggested that market conduct fines are frequently disproportional to the infraction. In larger companies, a market conduct fine may be just another cost of doing business. A market conduct fine or other sanction, in our case, could have major consequences due to our small size. In the end, we try to do the right thing by conscientious underwriting and pricing that follows the best assessment of satisfying market conduct. Months or years later, those business decisions may be viewed in a completely different light by a market conduct examiner. We would cast a vote for Federal standards in the area of market conduct because it just makes sense to a small insurer.

Potential Role for Federal Standards

In the preceding comments, I have tried to illustrate some key areas where a small insurer with a nationwide business opportunity is disadvantaged by delays and differences in the regulation of insurance from many states. My purpose today is not asking for a free pass because of our small size and I am not here to castigate state regulation of insurance. But our companies have seen and experienced so many instances where regulations in one state seem trivial while those in another state become, in effect, a national standard for conducting our business affairs.

The insurance regulatory matters before the Subcommittee in the past and today are very important to our Company and all other insurers, big or little, that want to serve a customer base in numerous states. In the simplest of terms, we sell a promise to pay when our policyholder has a liability claim. Our business credo is to serve the needs of a constantly changing liability picture for policyholders while continuing to build our financial strength. A claim for liability can arise in any state at any time and the claim doesn't neatly fit into the boundaries of insurance coverage protection as defined by any one state that happens to be the policyholder's place of business. I encourage the Members of this Subcommittee to continue your gathering of facts, experiences and opinions about the movement toward Federal standards that could improve selected areas of state insurance regulation.