



NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

Testimony of
SENATOR KEMP HANNON

Chair, Health Committee
New York Senate

Co-Chair, NCSL Task Force to Streamline and
Simplify Insurance Regulation

On behalf of the
NATIONAL CONFERENCE OF STATE LEGISLATURES

Regarding
REFORMING INSURANCE REGULATION—MAKING THE
MARKETPLACE MORE COMPETITIVE FOR CONSUMERS

Before the
FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES

UNITED STATES HOUSE OF REPRESENTATIVES

NOVEMBER 5, 2003

**Testimony of Senator Kemp Hannon, New York
Co-Chair, NCSL Task Force to Streamline and Simplify
Insurance Regulation**

Good afternoon. I am New York State Senator Kemp Hannon. I chair the Health Committee in the New York Senate. Since 2001, I have served as co-chair of the National Conference of State Legislatures' (NCSL) Task Force to Streamline and Simplify Insurance Regulation. I am pleased to testify before you today on state legislative efforts to streamline, simplify and coordinate insurance regulation to meet the needs of the modern economy.

On behalf of the nation's state legislatures, I would like to make four major points.

- First, insurance is a different kind of product that is best regulated at the state level. For 152 years, state insurance regulation has successfully and effectively protected consumers and ensured the safety and soundness of insurance companies operating in the United States.

- Second, state legislatures and insurance commissioners have developed a shared vision for modernizing insurance regulation while preserving the advantages of the state system. NCSL, the National Conference of Insurance Legislators (NCOIL) and the National Association of Insurance Commissioners (NAIC) have worked closely at the national level to implement this vision. States have made significant progress in critical areas and expect to achieve widespread reform in all major areas in the years ahead.

- Third, state legislatures are moving forward at the state level to enact significant statutory changes to streamline and simplify state laws. NCSL has endorsed model legislation to create a multistate system to regulate life insurance products according to uniform national standards. This is only the third time in its 28-year history that NCSL has endorsed model legislation. NCSL also has endorsed a statement of principles to guide legislative efforts to modernize property and casualty insurance rate and form

requirements. State legislatures have passed laws to provide producer licensing reciprocity and to meet and exceed federal standards for insurance information privacy. Furthermore, state legislatures are exercising legislative oversight to ensure that regulatory reforms at the state level are instituted and work.

- Fourth, NCSL believes that any federal legislation in the area of insurance regulation would be a tremendous mistake. It would endanger effective state regulation, threaten the creation of a vast, costly new federal bureaucracy, and introduce a host of unintended consequences risking consumer protections, insurer solvency, and the strength and stability of the insurance marketplace.

A Different Kind of Financial Product

Insurance serves as the cornerstone of the economy. It provides economic security for individuals and their families and allows businesses to manage the risks that are inherent in economic activity. Whereas banking and securities are about access to capital and risk-taking, insurance is a guarantee. It is a legal promise—steeped in state tort and contract law—to pay a claim if and when benefits are due, often years into the future. When the unanticipated happens or the unthinkable occurs, insurance is there to provide the money to compensate for economic loss and to assist with recovery.

Because insurance is a different kind of financial service, it requires a different kind of regulation that states are best suited to provide. Insurers charge people different rates based on personal characteristics and where they live. They also can decline to offer a policy. The very nature of insurance requires insurers to set the price for a product before they know their largest expense. Instead, insurers project costs based on prior experience and loss estimates. These unique features require a level of practical expertise and political understanding that is well established at the state level.

People turn to insurance at their most difficult and vulnerable times—after the loss of their home, health, income, or a loved one. When an insurer does not pay or acts unfairly, states regulators can intervene within days or hours when it could take a distant federal

bureaucracy weeks or months to act, if at all. For a product as personal and important as insurance, regulation closest to home makes more sense.

State Regulation is Successful and Effective

The states have proven that they effectively and successfully protect consumers and make certain that promises made by insurers are kept. State regulation ensures that rates are fair, adequate and not excessive; that policy language is clear and includes what it should; that insurers are financially sound; that claims are paid; that consumers are informed and that their complaints are investigated and resolved.

State regulation is accessible, accountable and responsive, and operates with greater efficiency than would a vast new federal bureaucracy. Decentralized authority promotes regulatory innovation and safeguards against the imposition of rigid regulatory controls that may have adverse consequences that are national rather than local in scope. Furthermore, state legislatures are uniquely positioned to set policies that accurately reflect the values and concerns of local citizens. The nation's economy as a whole benefits from regulation that serves local needs as well as regional and national markets.

Insurance Regulation for the Modern Economy

State legislatures are strongly committed to preserving the states' role as the sole regulators of the business of insurance. In taking this position, state lawmakers accept the responsibility of creating a system of regulation that meets the needs and challenges of insurance companies competing in the modern financial marketplace.

NCSL has worked closely with the NAIC to develop a shared vision for modernizing insurance regulation while preserving the many benefits of the state system. Our collaboration led to the unanimous endorsement this July by the NCSL Executive Committee of the Interstate Insurance Product Regulation Compact and a Statement of Principles for the regulation of property and casualty insurance. Furthermore, NCSL supports regulatory efforts to streamline, simplify and coordinate insurance regulation. We applaud the NAIC's "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan" to achieve

modernization in seven critical areas. State legislatures and commissioners are working together at the national level and in individual states to make this vision a reality.

Historical Background

State legislatures took the first step to modernize state systems in the early 1990s when faced with a rash of insurer insolvencies tied to the savings and loan crisis. Unfortunately, the insolvencies occurred in a handful of states where insurance regulation was weak and at a time when there was insufficient coordination among state insurance departments. In response, NCSL established a special insurance solvency task force, which collaborated with the NAIC to draft and recommend 11 model bills to strengthen state regulation, to reduce filing burdens on multistate insurers and to allow for greater coordination among state insurance departments. In the first such action in our history, in 1991, NCSL endorsed the package of model legislation, which in two years was enacted in virtually all states. This swift action by state legislatures and insurance commissioners working together at the national level successfully stemmed the tide of insolvencies and helped avert the creation of a federal insurance regulator, which we believe would have proven a terrible mistake.

Financial Modernization

In recent years, the states have joined a concerted effort to adjust insurance regulation to meet the needs of the modern integrated marketplace while maintaining and improving consumer protections. The Gramm-Leach-Bliley Financial Modernization Act of 1999 tore down Depression-era barriers and created a comprehensive framework to permit affiliations among banks, securities firms and insurance companies. Gramm-Leach-Bliley also directed state actions in a few areas while implicitly calling on states to go beyond the specific mandates of the act to modernize insurance regulation.

States accepted this challenge with remarkable vigor. In March 2000, the nation's insurance commissioners endorsed a "Statement of Intent" to make insurance regulation more effective and efficient in several defined areas. State legislatures joined regulators to meet the specific federal mandates. Since Gramm-Leach-Bliley, 48 states have passed

producer licensing reciprocity legislation and 49 states have met or exceeded the federal standard to ensure the privacy of insurance information. Equally impressive are efforts by insurance commissioners—working through the NAIC—to retool virtually every aspect of insurance regulation, from implementing a uniform electronic product filing system to standardizing company licensing applications to rewriting the handbook for market conduct exams that are used to audit and examine company practices.

Streamlining and Simplifying State Laws

NCSL recognized the importance of state legislatures taking a proactive role to modernize insurance regulation. In 2001, NCSL established the *Task Force to Streamline and Simplify Insurance Regulation* to provide a national forum for state legislatures to engage the issues facing insurance regulation in the changing financial marketplace and, if necessary, to develop and recommend model legislation. The Task Force included a diverse range of members from across the country as well as the officers of NCOIL, which provided invaluable input, assistance, research and advice to the Task Force throughout the process.

The Task Force met regularly over a two-year period with three primary objectives:

- To preserve the primacy of state insurance regulation;
- To consider reforms that would allow insurance companies to compete more effectively in the integrated financial marketplace and to respond with innovation and flexibility to evermore demanding market forces; and
- To maintain and improve consumer protection, which is the hallmark of the state system, while expanding consumers' access to new products.

The Task Force worked closely with the NAIC, industry and consumers to explore broadly the many areas of insurance regulation—including producer licensing, privacy, market regulation, consumer protection, and company licensing. Following these consultations, the Task Force identified "speed to market" issues as the area in greatest need of state legislative action. "Speed to market" refers to the ability of insurers to bring

new products to market in a timely and efficient manner according to reasonable and transparent standards.

The Task Force reached consensus on two proposals for state legislative consideration: 1) the Interstate Insurance Product Regulation Compact for the regulation of life insurance and annuity products; and 2) a Statement of Principles for the regulation of property and casualty insurance. The NCSL Executive Committee unanimously endorsed both proposals in July 2003.

Insurance Regulation Compact

One area of insurance regulation that generated early consensus was the need for a multistate system to regulate life insurance and annuity products. Although these investment-oriented policies are still insurance products and—thus—best suited for state regulation, they compete in the integrated financial marketplace against the products of banks and securities firms, which receive less rigorous regulatory review. Unlike other insurance policies, life products rely largely on actuarial tables that are national in nature. Furthermore, 50-state standards and reviews can delay consumers' access to new products, divert limited state resources, and create problems when holders of these long-term policies move from state to state. A state-based solution that brings new products to market more quickly and efficiently according to uniform national standards promises significant benefit to consumers, regulators and industry.

In March 2002, insurance commissioners endorsed the concept of an interstate compact as the vehicle for reform. Commissioners met with the NCSL Task Force throughout the summer to discuss the compact proposal. The Task Force expressed support for the concept and offered guidance to the NAIC through its process on critical elements of the proposal, including the structure of the management committee, supermajority voting for uniform product standards, and legislative participation. The NAIC adopted all of the Task Force's recommendations and continued to work with industry, consumers, and state attorneys general on the proposal during the fall. In December 2002, the NAIC

overwhelmingly adopted the Interstate Insurance Product Regulation Compact Model Act for review, input and consideration by other state officials.

The NCSL Process

Immediately following the NAIC action, the Task Force undertook a detailed review of the proposal and began to consider possible amendments to the Model Act to address legislative concerns. A notable contribution to this discussion was an extensive report submitted by the attorneys general of California, Minnesota, Missouri and Oklahoma that raised a number of important issues. Additionally, many academics, legal experts, and industry and consumer representatives provided extensive input on the Compact. The Task Force also drew upon lessons from legislative consideration of the insurance receivership compact in the early 1990s and legislative deliberations in the three states where the Compact was considered with some success in 2003.

In the end, the Task Force recommended 10 amendments. Among other things, the amendments elaborate on open meeting requirements and procedures, guarantee public inspection of compact documents, and more specifically frame authority to rule on product standard violations by insurers.

The most difficult issue surrounded language pertaining to the binding effect of the Compact on member states. The principal concern of attorneys general was potential unintended consequences of the Compact on states' general consumer protection laws, specifically unfair and deceptive trade practices laws. Assistant attorneys general from at least 22 states participated in Task Force discussions. The Task Force brokered discussions between working groups of assistant attorneys general, regulators and industry to successfully draft compromise language that achieves the purpose of the binding effect provision while effectively preserving the authority of state attorneys general. During a plenary session of all insurance commissioners in July, the NAIC without dissent revised the Compact Model Act to accept the recommendations of the NCSL Task Force. The American Council of Life Insurers also supports the revised Compact Model Act.

'Speed to Market' for Life Insurance Products

The Interstate Insurance Product Regulation Compact represents only the third time in its history that NCSL has endorsed model legislation. The first time was in 1991 to enact uniform insurance solvency regulation. The second occasion was a year ago when NCSL endorsed a multistate agreement—enacted by 20 states in 2003—to simplify the nation's sales tax laws. Once enacted by 26 states or states representing 40 percent of the nation's insurance premiums, the Compact will create a multistate system to receive, review and quickly make regulatory decisions on insurance product filings according to national uniform standards. The Compact will cover life insurance, annuity, disability income, and long-term care insurance products.

The Compact includes a few key elements. First, it will allow member states to pool their resources and expertise to approve new products but retain control over market regulation, financial solvency, claims settlement, consumer complaints, and the enforcement of consumer protections. Second, a commission with one member from each state will govern the Compact while a 14-state management committee—with membership corresponding to states' share of premium volume—will oversee daily operations. Third, supermajority-voting requirements for the approval of product standards will promote higher consumer protections in exchange for national uniformity. Fourth, states will be able to opt out of uniform product standards by legislation and regulation if they do not meet the needs of the state. Finally, a legislative committee will oversee Compact activity and make recommendations, and governors and legislatures from member states will receive regular notice of Compact actions as well as an annual report.

NCSL believes that the Compact is the best way to preserve the advantages of the state system while raising product standards and consumer protections, improving the quality of product review, and giving insurance companies the regulatory efficiency that they need to compete in the new financial marketplace. Furthermore, NCSL is committed to

working with insurance commissioners and others to enact the Compact Model Act and make "speed to market" for life insurance products a reality in the near future.

Property and Casualty Issues

NCSL also recognizes the new economic realities faced by property and casualty (P/C) insurers. Because these insurance products are closely tied to local economic and geographic conditions, NCSL does not believe that a uniform regulatory approach is required. Instead, NCSL has endorsed a Statement of Principles for the regulation of P/C insurance to guide state legislative efforts to streamline, simplify and coordinate the regulation of P/C insurance.

In its Statement of Principles, NCSL encourages state legislatures to consider systems of product regulation that rely on competitive forces to determine P/C rates and promote the more efficient introduction of new products into the marketplace. States also may want to consider systems that provide commercial insurers greater flexibility to respond to the ever-changing needs of American business. However, NCSL encourages states to move toward market-based systems while preserving their authority to take action in a noncompetitive market or against rates that are inadequate or unfairly discriminatory.

NCSL believes that there exist a wide range of models for states to draw upon as they look to modernize rate and form regulation, including the NAIC Commercial Lines Modernization Model Act and the NCOIL P/C model act and others that apply to personal as well as commercial lines. Legislatures also may want to look at models in place in a wide range of states with dynamic, competitive insurance markets and consider those features best suited to the unique conditions in their state.

States Are Modernizing Property and Casualty Regulation

Nearly two-thirds of states now rely on market-based systems to regulate property and casualty insurance rates and forms and many states have added special provisions to exempt large commercial policyholders. Some form of competitive product regulation is

used in 32 states and the District of Columbia and 19 states have enacted P/C commercial lines re-engineering for more sophisticated insurance buyers.

Despite difficult insurance markets this year, several major P/C modernization efforts were enacted by state legislatures in 2003. New Jersey enacted comprehensive reform legislation to increase competition by addressing the state's excess profits and take-all-comers laws. Louisiana passed a flex-rating law for auto and homeowners insurance modeled on the South Carolina auto insurance reform of 1998. New Hampshire approved a new system that mixed the NCOIL model for personal lines and the NAIC commercial model while significantly lowering its threshold for exempt commercial policyholders. Nebraska enacted commercial lines modernization. Moreover, despite widespread cries to significantly regulate the Texas insurance market following significant volatility in the state's homeowners insurance market, the legislature adopted a market-based system, which also allows insurers to file policy forms for approval. Additionally, market-based systems either passed one chamber or showed signs of success in Florida, Georgia, Minnesota, Nevada, Rhode Island, South Carolina and Washington.

Insurance Regulatory Modernization Action Plan

The NCSL Task Force focused on "speed to market" issues because they were identified as the highest financial modernization priority and the one that required the greatest legislative involvement. As we follow-through with the Compact and P/C insurance modernization, NCSL recognizes that state legislatures also have an important role in other critical areas of reform, even those that are primary regulatory in nature.

Therefore, NCSL looks forward to working with the NAIC to implement the "A Reinforced Commitment: Insurance Regulatory Modernization Action Plan." The seven major areas of reform in the plan include: i) consumer protection, ii) market regulation, iii) speed to market, iv) producer licensing, v) company licensing, vi) solvency regulation, and vii) change in insurance company control. We applaud the NAIC's initiative to update the principles outlined in the March 2000 "Statement of Intent" and

build upon these years of substantial improvement with a comprehensive vision to achieve widespread reform. We wholeheartedly endorse this plan.

Although the NCSL Task Force has concluded, state legislatures continue to take a proactive role at the national level. For this reason, in 2002, the NCSL established the Financial Services Standing Committee to give greater attention to banking, insurance, securities and other issues related to financial services. Representative Donna Stone, who chairs the House Economic Development, Banking and Insurance Committee in Delaware and served on the Task Force, now chairs the NCSL Committee. Representative Frank Mautino, who co-chaired the Task Force with me and chairs the House Insurance Committee in Illinois, and Representative Keith Faber, who served on the Task Force and is one of the most knowledgeable members on insurance issues in the Ohio legislature, both serve as vice chairs on the NCSL Committee. The Committee also is pleased to have Senator John Loudon, who chairs the Senate Small Business, Insurance and Industrial Relations Committee in Missouri, and Assemblywoman Patricia Wiggins, who chairs the Assembly Banking Committee in the California, serve as vice chairs on the NCSL Committee.

Federal Legislation Would Be a Mistake

I concluded my remarks with a couple comments on why state legislatures believe that any federal legislation would be a mistake. Federal intervention necessarily would undermine state consumer protections and solvency regulation—where the states have proven to be most effective. It would restrict the ability of state officials to respond to the needs of local markets, threaten the creation of a vast, costly new federal bureaucracy, and introduce a host of unintended consequences.

It is easy to theorize a perfect model of insurance regulation, but it is much more difficult to enact and establish one. As the chair of the Health Committee in the New York Senate, I have come to appreciate the unforeseen consequences of the Employee Retirement Income Security Act (ERISA) of 1974, which was the first significant federal effort in the area of insurance regulation. ERISA preempts state laws for employer-sponsored benefit

plans, which provide health benefits to the great majority of privately insured Americans. The act effectively transferred authority from the states to the Department of Labor and federal judiciary and created the system largely responsible for giving insurance a bad name. It is easy to see how similar unforeseen consequences could materialize if the federal government were to preempt or restrict state authority to regulate in the areas of life and property and casualty insurance.

Conclusion

In conclusion, insurance is a unique product. States have successfully and effectively regulated it for 152 years. State legislatures and insurance commissions are working together to streamline, simplify and coordinate state regulation while protecting consumers and preserving the advantages of the state system. We believe that state reform rather than federal legislation offers the best promise for a system of insurance regulation that meets the needs of consumers and the nation in the 21st century.

Thank you for this opportunity to offer you testimony on behalf of the nation's state legislatures. I look forward to responding to your questions.