Statement of

Markham R. McKnight, CPCU

President & CEO, Wright & Percy Insurance

on

Reforming Insurance Regulation – Making the Marketplace More Competitive for Consumers

Before the

House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

November 5, 2003
Washington, D.C.

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My name is Markham McKnight, and I am the President and CEO of Wright and Percy Insurance which is headquartered in Baton Rouge, Louisiana. Our firm, founded in 1882, offers financial and risk services and insurance products to both personal and commercial customers throughout the southeastern United States.
In a development that I think is indicative of the growing convergence that is taking place in the financial services industry in the wake of the passage of the Gramm-Leach-Bliley Act, Wright & Percy Insurance was acquired in May, 2003, by BancorpSouth, Inc., a bank holding company with commercial banking and financial services operations in Mississippi, Tennessee, Alabama, Arkansas, Texas and Louisiana. I retain the title of president and CEO of Wright & Percy for BancorpSouth Insurances Services, Inc.. I believe that this merger will allow both Wright and Percy and Bancorp South to better serve our customers. My initial exposure to the dual-chartering system for banks also has been a revelation and has reaffirmed my personal commitment to the enactment of an optional federal charter for insurers. I also am privileged to be serving as the Chair of the Government Affairs Committee of The Council of Insurance Agents + Brokers (“The Council").

I’d like to thank you, Chairman Baker, for giving me the opportunity to testify before the Subcommittee today. I would like to commend you for holding this series of hearings to examine the shortcomings in the state-based insurance regulatory system and to explore the different approaches that have been advanced to modernize that regulatory system and whether the National Association of Insurance Commissioners’ action plan to achieve such modernization without Congressional intervention is viable. One of the reasons I chose to become active with The Council is that it has been a pioneer within our industry on the modernization issue – though reform is a frustratingly long process. We formed our first internal committee to address the problems of interstate insurance producer licensing more than 60 years ago. Our efforts were finally rewarded with the enactment of the NARAB provisions of the Gramm-Leach-Bliley Act a few years ago – a first step on the road to insurance regulatory modernization. I thank you, Mr. Chairman, and other members of this committee on both sides of the aisle for your active support of the NARAB provisions during the conference on the Gramm-Leach-Bliley Act.

NARAB was a true provision of modernization in the Gramm-Leach-Bliley Act. Were it not for the tenacious support and initiative from you and Congresswoman Kelly, and the leadership of Chairman Oxley, things assuredly would not be changing for the better - particularly at their current pace. This initiative was bipartisan, and provides a very good model for a carrot-and-stick, goals-and-timetables approach that can effectively move insurance regulation forward toward goals of efficiency.

The NARAB approach to regulatory modernization is but one of the approaches that your Subcommittee has been examining in these hearings. I have been leading an effort to study the different routes for achieving modernization in the insurance regulatory process. To that end, The Council's Foundation for Agency Management Excellence (FAME) last year commissioned an independent study of the economic costs and benefits of these various proposals (the "FAME Study"). While it is abundantly clear that the current system of state-by-state regulation is not working, we wanted to see a full, economic analysis of the alternatives for reform. The study, entitled "Costs & Benefits of Future Regulatory Options for the U.S. Insurance Industry," provides an in-depth examination of the pros and cons of the regulatory options available for oversight of the business of insurance. The study was released during the hearing you held to examine these issues last year, and I hope that the study has served as a useful tool as the Subcommittee has continued its examination of various regulatory alternatives.

Even though the states have made some strides in recent years in simplification and streamlining – thanks to the enactment of the NARAB provisions of Gramm-Leach-Bliley – there are still several problem areas in the interstate licensing process that cost agents and brokers time and money unnecessarily. Insurance companies also face problems in doing business on a multi-state basis, and recent efforts by the states to streamline rate and policy form approval processes have not proven to be very successful. These continuing issues with the state-by-state regulatory process lead us to the following conclusion: relief is needed, and it is needed now. I urge the Committee to enact relief, and to do it soon.

I believe that it is critical to the long-term viability of the U.S. insurance industry that Congress pass legislation creating an optional federal charter for insurers. Broader reforms to the insurance regulatory system are necessary to permit the industry to operate on a more efficient basis. Such broader reforms, like an optional federal charter, are also necessary to enable the insurance industry to compete in the larger financial services industry and also to be able to compete internationally. There also is a more immediate need, however, for reforms that cannot wait for the resolution of the federal charter debate. I would like to focus on three areas that could greatly benefit from immediate reforms that would be relatively easy to implement.

1. Make The NARAB Licensing Reciprocity Requirements Apply To All 50 States

The NARAB provisions included in the Gramm-Leach-Bliley Act required that at least 29 States enact either uniform agent and broker licensure laws or reciprocal laws permitting an agent or broker licensed in one State to be licensed in all other reciprocal states simply by demonstrating proof of licensure and submitting the requisite licensing fee.

The NAIC pledged not only to reach reciprocity in producer licensing, but also to reach uniformity in producer licensing as their ultimate goal. The NAIC amended its Producer Licensing Model Act (PLMA) to meet the NARAB reciprocity provisions, and worked to get the PLMA enacted in all licensing jurisdictions. As of today, 47 states have enacted some sort of licensing reform. Most of those states have enacted the PLMA, but four states have enacted only the reciprocity portions of that Model Act. Of the states that have enacted the PLMA, there are several states that have deviated significantly from the original language of the Model Act. One state, Florida, has enacted licensing reform that in no way resembles the PLMA. And Florida is joined by California as the largest of states in terms of insurance premiums written that have not enacted legislation designed to meet the NARAB reciprocity threshold at all.

The NAIC has now officially certified that a majority of states have met the NARAB reciprocity provisions, thereby averting the creation of NARAB. While that is a commendable accomplishment, there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions – and I am not sure that the NAIC will be able to meet that goal. This is especially troubling, given the threat of federal intervention that was implicit in the NARAB provisions of Gramm-Leach-Bliley.

Indeed, until just last month, the State of Florida completely barred non-residents from being licensed to sell surplus lines products to Florida residents or resident businesses and required non-resident agents or brokers who sold a policy of an admitted company to a Florida resident or resident business to pay a resident agent a mandated "countersignature fee" in order to complete that transaction. These practices have been terminated only because The Council filed a lawsuit and was granted summary judgment on its claims that these statutory requirements violated the constitutional rights of its members. The State has opted not to appeal. We should not have to resort to lawsuits, however, to defeat these protectionist laws and to put ourselves in a position to serve our clients and to do so in an efficient manner. Three other jurisdictions – Nevada, South Dakota and West Virginia – currently retain their protectionist countersignature laws.

I do not believe that the NAIC – despite its ambitious reform agenda – is in a position to force dissenting States to adhere to any standards it sets. Congress can, however, by mandating that all 50 States enact uniform licensure laws or laws permitting an agent or broker licensed in one State to be licensed in all other States on a reciprocal basis and preempting all State insurance laws that discriminate against non-resident agents and brokers as the Florida provisions were found to have done.

Under the NARAB provisions of the Gramm-Leach-Bliley, if the threshold requirements are not satisfied, then the Act provided for the formation and organization of the National Association of Registered Agents and Brokers. These provisions were modeled after the National Association of Securities Dealers. If new, 50 State requirements were enacted and they were not satisfied, then the National Association of Registered Agents and Brokers would function in a manner similar to the NASD if the Gramm-Leach-Bliley Act provisions providing for its creation and operation were maintained. It would create a national licensing clearinghouse where multistate insurance producers could obtain multiple licenses through a single point of filing. It would also likely set a higher standard for licensure than currently exists in any one state, but one that is based on the professional qualifications of the individual. The National Association of Registered Agents and Brokers would also provide a centralized enforcement mechanism that would enable regulators to get bad actors out of the system sooner rather than later.

A large portion of the regulation of registered securities representatives is done through the NASD, which is a self-regulatory organization established by Congress and overseen by the Securities and Exchange Commission. Registered securities representatives must still procure licenses in all states in which they wish to sell securities, but they can procure those licenses by going through one central location – the NASD's Central Registration Depository (CRD). The CRD processes registrations for the NASD and for six other securities exchanges. An individual seeking licensure with multiple organizations and/or states need only submit a uniform registration form and payment of the requisite fees. The NASD also provides a centralized authority for the enforcement of securities laws and the development of national enforcement policies. The NASD's Enforcement Division prosecutes securities violations discovered by the NASD and also receives enforcement referrals from the SEC and the various state securities regulators.

Self-regulatory organizations (SROs) like the NASD provide a good model that could easily be modified to address the regulation of insurance producers. SROs are used quite commonly to regulate professional activities. For example, state bar associations are SROs that provide oversight of the legal profession. The concerns with state-by-state licensing for insurance producers have never had anything to do with state regulation of insurance producers. Rather, the concerns have arisen from the myriad of idiosyncratic requirements that often have little or nothing to do with the professionalism of our members. A single set of licensing requirements and rules of conduct that are meaningful in terms of expertise and proficiency would be highly preferred, even if that means meeting the highest of standards that currently exist.

The Subcommittee should strongly consider the use of an SRO to address the continuing problems in interstate producer licensing, whether as part of an optional federal charter bill or as part of any other interim reforms that the Subcommittee would consider. Using a supervised SRO to regulate industry activities might result in significant efficiencies and savings for consumers without diminishing the consumer protections in place today.

It is important to note that nothing in the federal securities laws authorizes any specific entity to act as the SRO for securities brokers; rather it provides for the creation of SROs to regulate securities broker/dealers subject to SEC oversight. This same approach could work well in the insurance industry, as it would permit each segment of the producer marketplace (life, health, and property/casualty) to address its own unique issues. The supervising regulator could be housed in either an independent commission or as a part of an existing agency.

The SRO concept fits well with the optional federal charter proposals advanced by several of the groups who have already testified before this Subcommittee. I hope that you would consider adding it to any optional federal chartering legislation drafted by the Subcommittee. The SRO concept, however, also is a good example of a goal that could be achieved as an interim step towards optional federal charter legislation.

2. Speed To Market

There are some other problems with the state-by-state system of insurance regulation that deserve immediate attention and that could also be stepping stones in the path towards the optional federal charter. While these problems appear to affect insurance companies more than insurance agents and brokers, we would argue that the restraints imposed by the state-by-state regulatory system on these areas affect our members just as much as the companies.

My agency – like most Council members – sells and services primarily commercial property/casualty insurance. This part of the insurance industry is facing some severe challenges today due to a number of factors, including the losses incurred as a result of the terrorist attacks on September 11, 2001; increased liabilities for asbestos, toxic mold, D&O liability and medical malpractice; and years of declining investment returns and consistent negative underwriting results. Some companies have begun to exit different insurance markets as they realize that they can no longer write these coverages on a break-even basis, let alone at a profit. The end result is increased prices and declining product availability to consumers. This situation is only being exacerbated by the current state-by-state system of insurance regulation.

The FAME study mentioned earlier in my testimony notes that the current U.S. system of regulation can be characterized as a prescriptive system that generally imposes a comprehensive set of *ex ante* constraints and conditions on all aspects of regulated entities' business operations. Examples of *ex ante* requirements include things like prior approval or filing of rates and policy forms. The prescriptive approach is designed to anticipate problems and prevent them before they happen. However, this approach to regulation hinders the ability of the insurance industry to deal with changing marketplace needs and conditions in a flexible and timely manner. Consequently, it also hinders the ability of regulators to quickly address emerging problems. The prescriptive approach to regulation also encourages more regulation than may be necessary in some areas, while directing precious resources from other areas that may need more regulatory attention.

It is also important to note that states wishing to do business on a national basis must deal with 51 sets of *ex ante* requirements. This tends to lead to duplicative requirements among the jurisdictions, and excessive and inefficient regulation in these areas. Perhaps the best (or worst, depending upon your perspective) example of this are the policy form and rate pre-approval requirements still in use in many states. Over a dozen states have modernized the commercial insurance marketplace for rates and forms, meaning that there are no substantive regulatory approval requirements in these areas at all. Other states, however, continue to maintain pre-approval requirements. Indeed, some studies have shown that it can take as much as two years for a new product to be approved for sale on a nationwide basis. Banking and securities firms, in contrast, can get a new product into the national marketplace in 30 days or less. The lag time for the introduction of new insurance products is unacceptable, and it is increasingly putting the insurance industry at a competitive disadvantage as well as undermining the ability of insurance consumers to access products that they want and need.

Congress should address these problems either by limiting the States' pre-approval authority directly, or by establishing some sort of NARAB-like incentives to encourage the States to do it on their own (or have it done for them should they fail).

3. Increasing Access To Alternative Markets

In the last year, high rates for property and casualty insurance have been a serious problem for many mid-sized and larger commercial firms. Congress should explore ways that alternatives to the traditional, regulated marketplace can be fostered to provide a viable alternative for sophisticated insurance consumers. Two mechanisms that help stem increasing rates are the use of surplus lines products and risk retention groups.

Surplus Lines. For commercial property and casualty insurance, more and more business is done through the surplus lines marketplace. A surplus lines product is an insurance product that is sold by an insurance company that is not admitted to do business in the state in which the risk insured under the policy is located. The products tend to be more efficient because the issuing companies are more efficiently regulated and because the policies are manuscripted and therefore need not comply with state form and rate requirements. In essence, the insured goes to wherever the insurer is located to purchase the coverage. The insurer may be in another State, or it may be in Great Britain, Bermuda or another country. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers.

Although the purchase of this type of insurance is perfectly legal in all States, many States have enacted two different types of requirements that can greatly limit is usefulness. First, some States either completely prohibit (like Florida did) or greatly hinder non-resident brokers from placing surplus lines coverage for a risk located in those States. Second, almost every State imposes a premium tax obligation for surplus lines premiums. The problem in this regard is that the States have conflicting rules with respect to the portion of the premium on which the tax must be paid. Some States, for example, dictate that tax must be paid on 100 percent of the premium even if only a small percentage of that premium is associated with risks being insured in those States. These problems are particularly problematic when insuring companies with a national presence that could most benefit from the use of a surplus lines product but that must grapple with the morass of conflicting regulation to realize such benefits.

My hope is that Congress can act to alleviate these problems by preempting the State requirements that discriminate against non-resident brokers in any way and by creating some sort of incentive or requirement for the States to rationalize their irrational surplus lines premium tax formulae.

Risk Retention Groups. Enacted in 1981, the Product Liability Risk Retention Act was developed by Congress in direct response to the insurance "hard market" of the late 1970s. The current version of the Act – the Liability Risk Retention Act of 1986 – was enacted in response to the "hard market" of the mid-1980s and expanded the coverage of the Act to all commercial liability coverages. Risk Retention Groups (RRGs) created under the Act are risk-bearing entities that must be chartered and licensed as an insurance company in only one State and then are permitted to operate in all States. They are owned by their insureds and the insureds are required to have similar or related liability exposures; RRGs may only write commercial liability coverages and only for their member-insureds. The rationale underlying the single-State regulation of RRGs is that they consist only of "similar or related" businesses which are able to manage and monitor their own risks. The NAIC has recognized that the purpose of Risk Retention Groups is to "increase the availability of commercial liability insurance" and it has been a success in that regard as it has created an alternative that many have ceased. Congress should expand the availability of RRGs by expanding the Act to allow for the insuring of property damage as well as liability exposures. This would provide another alternative for businesses seeking economical insurance solutions in difficult economic times for the insurance industry.

Moving Forward?

The FAME study notes that all of the regulatory modernization efforts put forward by the NAIC in the past several years have been the direct result of major external threats – either the threat of federal intervention, or the wholesale dislocation of regulated markets. It concludes that there is no guarantee that the state-based system will adopt further meaningful reforms without continued external threats to its jurisdiction, and offers the states' progress on producer licensing reform as a prime example. I wholeheartedly agree with this conclusion, and urge this Subcommittee to continue to press the states to enact meaningful reforms to the insurance regulatory system.

Chairman Baker, I believe that you and others on your Subcommittee were absolutely on target when you talked about the need for immediate Congressional action to address the continuing problems in the state-based regulatory system. While I ultimately support the enactment of an optional federal charter, I know that we can't wait for that debate to play out before getting some relief from duplicative and inefficient regulation that has little impact on the effectiveness of the insurance regulatory system. There are several targeted reforms that the Congress could address now that will benefit not only the insurance industry but also the consumers we serve. As discussed above, the areas deserving immediate attention include further reforms to the producer licensing system, addressing the speed-to-market shortcomings in the current state system by eliminating prior approval of rates and policy forms, similar to the successful model used in Illinois, and enacting legislation that could expand access to alternative insurance marketplaces for commercial insureds.

Mr. Chairman, you have asked witnesses at the past two hearings to give you a timeline for achieving additional reforms in the insurance regulatory system, but you were not able to get a direct answer. I'd like to give you my suggestions for how to proceed with future reforms.

The reforms to the producer licensing system, the speed-to-market reforms, and the measures designed to expand access to alternative marketplaces mentioned above need to occur as soon as possible – preferably, within the next year. These reforms will provide the most immediate relief from inefficient and duplicative regulation for the industry.

The NAIC is working on further reforms that are currently in their fledgling stages, like an interstate compact to facilitate a single point of filing and approval for life insurance products. Additionally, the NAIC is in the process of developing standards for coordination of market conduct examination. While we support the efforts of the NAIC in these areas, our experience with NARAB cautions us to be wary of their success. Eighteen months ago, a representative of The Council testified before this Subcommittee and suggested that the Subcommittee continue to monitor the progress on these initiatives over the next 18 months and to be ready to act to implement reforms in these areas if the states' efforts should fail to take hold. That 18 months has now come and gone and the states' efforts have failed to take hold; Congress should act now to fill the gap.

I urge the Subcommittee, however, to continue with its work on the optional federal charter even as it develops interim reforms. The enactment of an optional federal charter is essential to the U.S. insurance industry's long-term survival. While there are more immediate reforms that can be made to the insurance regulatory system, those reforms in no way preclude the ultimate need for an optional federal charter. The FAME study mentioned above has come to the same conclusion:

> Regardless of whether the states undertake significant further reforms, the inexorable trend seems to lead away from continued state regulation. If states fail to undertake significant reforms, the state system will become increasingly unsuitable to the current environment and generate tremendous pressure for wholesale change. If, on the other hand, the states undertake significant reforms and achieve a greater degree of uniformity, reciprocity and comity, those reforms will help set the stage for a further move toward federal regulation.

There is one other consideration that the Subcommittee should keep in mind as it begins its work on reforming the insurance regulatory system. It is critical for the Subcommittee to continue to monitor the progress made by the states in all areas of regulatory modernization. As noted above, improvements in the state insurance regulatory system have come about largely because of the leadership of this Committee, and through your continued oversight of the review process. I thank you for your attention to this critical issue, and also thank Chairman Oxley and Rep. Kanjorski for their leadership in this area. I hope that you will continue these efforts, as they benefit not only the insurance industry, but also the consumers that we serve.

In sum, Chairman Baker, I strongly agree with your early statements that Congress needs to consider short-term and long-term solutions. We need state-based reforms, we need continued federal oversight and pressure to reach uniformity in state laws, and we need you to continue laying the foundation for an optional federal charter. I urge this Subcommittee to begin work now on those reforms that are easily obtainable in the short-term – such as further producer licensing reforms, speed-to-market, and increasing access to alternative markets – as well as the long-term reforms, like an optional federal charter, that may require further examination and debate before enactment. I thank you, Mr. Chairman, for the opportunity to testify on this important issue, and stand ready to assist you in meeting these important goals.