STATEMENT
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING
AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES

July 28, 2011

Introduction

The Independent Insurance Agents & Brokers of America's (IIABA) support for state insurance regulation is well-known to observers of the insurance industry and to the members of the subcommittee, and we continue to confidently believe that states are the most appropriate and effective regulators of this vital financial sector. This longstanding position was vividly reinforced during the financial crisis of recent years. During challenging and tumultuous times, state insurance regulators ensured that insurers remained solvent, that claims were paid, and that consumers were protected. State regulators handle countless inquires and questions from consumers and understand the concerns and often unique conditions facing the citizens in their states. State regulation has a particularly long and stable track record of accomplishment in the vital areas of solvency regulation and consumer protection. Although

targeted federal legislation is sorely needed in a number of key areas to modernize and improve the state regulatory system, especially in the area of agent licensing, the underlying foundation on which the state regulatory system is based is strong and stable.

Dodd-Frank Act Implementation

It was only one year and one week ago today that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was signed into law. Regardless of one's views of Dodd-Frank, it was appropriate that the treatment of the insurance sector ultimately proved to be relatively noncontroversial. The decision not to dramatically restructure the state system was a conscious and welcome one, and it reflected the consensus among policymakers that the turmoil in the markets was not exacerbated by and did not significantly extend into the insurance world. The members of this subcommittee and your colleagues in the House and Senate recognized the steady performance of state insurance regulation during the financial crisis and concluded that sweeping action in the insurance arena was unnecessary and unwarranted.

Although the insurance sector was not the focal point of the Dodd-Frank reforms, there are several important and notable insurance-related provisions contained in the law. Three provisions are of particular interest to IIABA and are discussed in greater detail below.

Surplus Lines Regulation

For many insurance agents and brokers, the most notable insurance features of Dodd-Frank are reforms made to the surplus lines marketplace. These provisions – which are contained in the Nonadmitted and Reinsurance Reform Act (NRRA) and only took effect one week ago today – offer the possibility of meaningful reform and marketplace efficiency, but it is too early to determine with certainty whether their promise will be realized.

The NRRA surplus lines reforms attempt to eliminate much of the unnecessary duplication and redundancy that historically existed in this arena by embracing a single state regulatory approach. The law requires jurisdictions to respect the requirements and conclusions of the insured's home state and specifically provides that "the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home state." The net effect of these provisions is that only the surplus lines licensing, diligent search, disclosure, and all similar placement requirements of the home state are to apply in any particular transaction. The law also includes a clear preemption provision stating that "any law, regulation, provision, or other action of any state that applies or purports to apply to nonadmitted insurance sold to, solicited by, or negotiated with an insured whose home state is another state shall be preempted with respect to such application."

The move to a single state-home state regulatory system is a significant modernization of existing law, but NRRA also promotes interstate regulatory consistency by developing national standards in the areas of insurer eligibility and diligent search requirements. The inclusion of these additional provisions should be very beneficial to agents and brokers active in the nonadmitted insurance marketplace.

IIABA is optimistic about the establishment of a single state regulatory system and of national standards in these key areas, but the manner in which states implement and respond to this new paradigm will be critical. It is essential that state officials adhere to the letter and spirit of the law. States must resist the possible temptation to ignore the intent of these reforms and

attempt to circumvent the law by imposing state requirements that are inconsistent with the NRRA.

Many, but not all, states revised their surplus lines requirements in the 2011 legislative session in order to conform their state laws to the new federal requirements. It will be critical that all states achieve this same consistency. Although it is very clear that the NRRA will preempt state laws that are inconsistent with its standards, IIABA firmly believes that it is important to eliminate the possibility of confusion and conflict. While some states have pledged to no longer enforce state statutory and regulatory provisions that conflict with the NRRA, the best possible course is for these jurisdictions to avoid any possible ambiguity and simply repeal these requirements altogether.

The National Association of Insurance Commissioners (NAIC) has helped educate state insurance officials and the insurance industry about the scope and effect of the NRRA's non-tax provisions by issuing a sample bulletin. This sample bulletin provides helpful information in a "frequently asked questions" format and can be modeled for use by state insurance departments. IIABA urges more states to issue such guidance in their particular jurisdictions.

While IIABA remains hopeful that the NRRA's above-described non-tax provisions will be implemented as intended by Congress, we are more concerned by the implementation of the NRRA's tax provisions. The collection and distribution of surplus lines premium taxes has been a confusing and complex challenge for surplus lines brokers for many years, and the NRRA reforms address this problem by again embracing single state regulation and permitting only the home state of the insured to require the payment of premium taxes in connection with a surplus lines transaction or direct nonadmitted insurance placement. The statute leaves no ambiguity about the intended goal and provides that "[n]o state other than the home state of an insured may require any premium tax payment for nonadmitted insurance." We are increasingly troubled, however, that this simple provision may lead to an unintended result that <u>actually exacerbates</u> existing burdens and challenges.

The NRRA acknowledges that states may enter into interstate compacts or agreements in order to allocate premium taxes for multistate surplus lines risks, but participation in such a system is not required by the law. Two interstate alternatives – the Nonadmitted Insurance Multistate Agreement (NIMA) and the Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT) – are under development, but neither is functional or operational at this time. At least twelve states have so far expressed a desire to participate in the NIMA system (although no tax payment clearinghouse has been established), and nine states have enacted the necessary statutes to join SLIMPACT (although that interstate compact will not be fully operational before January 2013).

IIABA is closely monitoring and is concerned by the manner in which the potential interstate agreements address the allocation, collection, and distribution of premium taxes on insurance policies covering exposures in multiple states. We believe strongly that any allocation methodology must be efficient, sensible, and not result in increased burdens and compliance obligations for insurance brokers or purchasers of coverage. The NIMA agreement – which was developed by the NAIC's Surplus Lines Implementation Task Force and ultimately approved by the NAIC as a whole – currently contemplates an allocation methodology that is of considerable concern to the private sector, and it is one that fails to satisfy the principles that IIABA and others expect from such a system. NIMA's proposed allocation system would be more complex and cumbersome than that in place today and would require the collection of information that is not even utilized in the underwriting process.

While we have serious reservations about the NIMA proposal approved by the NAIC in late 2010, it is still possible for the participating NIMA jurisdictions to revise the allocation methodology before the system goes live. A number of preferable alternatives have been proposed, but perhaps the most viable of these options is a tax allocation proposal that has been crafted by the Kentucky Department of Insurance. Kentucky Insurance Commissioner Sharon Clark, who also chairs the NAIC's Market Regulation and Consumer Affairs Committee, has proposed a methodology that has considerable merit and addresses the biggest problems associated with the current NIMA allocation system. IIABA hopes the participating NIMA states will adopt this thoughtful proposal, and we urge them to do so at the earliest possible time.

The NRRA was intended to streamline and simplify the surplus lines regulatory system. It would be a very peculiar outcome and an unintended consequence of Congress's action if the NRRA's enactment ultimately prompted state officials to develop an even more complex and cumbersome regulatory structure for the agents, brokers, and purchasers of surplus lines insurance. IIABA intends to work with all parties, however, and remains hopeful that the promise of the NRRA can ultimately be realized.

Federal Insurance Office

In addition to playing a role in the implementation of the NRRA surplus lines provisions, IIABA is greatly interested in the manner in which the recently established Federal Insurance Office (FIO) will function. Congress, thanks in large part to the work of this subcommittee, clearly spelled out the purpose, role, and authority of the new office in Dodd-Frank, and it is imperative that the informational office operate as intended. The FIO serves a limited, albeit important, purpose and is authorized – among other activities – to monitor the industry, serve on the Federal Stability Oversight Council, and collect certain data from the industry. At the same time, however, it is important to remember the office's activities are restricted in many crucial ways and that the entity lacks any formal regulatory authority over the business of insurance.

IIABA welcomes and looks forward to working with the newly installed director of the office – former Illinois Insurance Director Michael McRaith – and expects that his lengthy experience as a regulator and advocate of state regulation will serve him well in his current capacity. We especially look forward to providing our input to the FIO as it begins its work on the study examining how to modernize and improve insurance regulation.

Financial Stability Oversight Council

For over 150 years, the United States has relied on an insurance system regulated by the states. This state-based system has proven its strength with a strong track record of protecting policyholders and claimants while simultaneously upholding the integrity of the insurance markets. As the Financial Stability Oversight Council (FSOC) continues to determine the entities it will deem systemically risky, warranting additional federal scrutiny, it should recognize that the insurance industry as a whole does not present a systemic risk.

There are several reasons why the insurance industry is not systemically risky. First, the system protects against insolvency and the insurance market is extremely competitive. If an insurance company becomes insolvent, the state insurance regulator has a process to wind down the failing institution, and a strong state guaranty fund protects the individual policyholders from losses. Second, the insurance marketplace is extremely competitive, so the loss of a single failed company typically does not produce gaps in the market.

Third, the insurance industry (particularly property casualty insurance) should not be considered systemically risky, as insurers carry lower leverage ratios and hold greater amounts of capital in relation to their liabilities than other financial institutions. As a result, this reduces their exposure to market instability. Fourth, the inherent nature of insurance reduces systemic risk because insurance companies are financed by premiums paid in advance and pay only when an insured event occurs. Unlike other potentially systemically-risky industries, the insurance industry is shielded from a potential run-on-the-bank scenario. Finally, as an additional safeguard, state regulators have broad authority to take insurers into receivership, effectively "walling off" their assets from the holding company and providing priority to policyholders. Any decision by FSOC to include insurance companies in its oversight should recognize these inherent differences between the insurance industry and other financial services sectors.

Producer Licensing Reform and the Need for NARAB II

While the enactment of the NRRA is an important step forward in the pursuit of meaningful regulatory modernization and will hopefully achieve its intended result, it is imperative that the state regulatory framework continue to advance and improve in other ways. While we support the preservation of the state system, we are just as strongly committed to the pursuit and implementation of regulatory and legislative reforms that address the weaknesses, inefficiencies, and unnecessary duplication that continue to hinder its effectiveness. State regulation offers considerable benefits, but the difficult truth is that sufficient progress on producer licensing reform and similar marketplace access issues have not been achieved. The need for effective licensing reform is greater than ever.

State law requires insurance agents and brokers to be licensed in every jurisdiction in which they conduct business, which forces most producers today to comply with inconsistent standards and duplicative licensing processes. These requirements are costly, burdensome and time consuming, and they hinder the ability of insurance agents and brokers to effectively address the needs of consumers. In fact, the current licensing system is so complex and confusing for our members that many are forced to retain expensive consultants or vendors or hire staff people dedicated to achieving compliance with the requirements of the states in which they operate.

Some observers mistakenly believe that most insurance agents operate only within the borders of the state in which they are physically located and that the problems associated with the current licensing system only affect the nation's largest insurance providers. The marketplace, however, has changed considerably in recent decades, and the average independent insurance agency today operates in more than eight jurisdictions. There are certainly agencies that have elected to remain small and perhaps only service the needs of clients in one or two states, but that is no longer the norm. For smaller businesses, which lack the staff and resources of larger competitors, the exorbitant cost and unnecessary complexity of ongoing licensing compliance is especially burdensome.

Congress recognized the need to reform the industry's multistate licensing system in the 1990s and incorporated the original NARAB subtitle into the Gramm-Leach-Bliley Act (GLBA). GLBA did not provide for the immediate establishment of the National Association of Registered Agents and Brokers (NARAB) and instead included a series of provisions that encouraged the states to reinvent and simplify the licensing process. In order to forestall the creation of NARAB, at least a majority of states (interpreted to be 29 jurisdictions) were required to license nonresidents on a reciprocal basis. To be deemed "NARAB compliant,"

GLBA mandated that states issue a nonresident license to any applicant who meets three simple criteria: (1) is licensed in good standing in his/her home state, (2) submits the appropriate application, and (3) pays the required fee. The act is precise and states that a nonresident license must be issued “without satisfying any additional requirements.” In short, GLBA required compliant states to accept the licensing process of a producer’s home state as adequate and complete, and no additional paperwork requests or other requirements are permitted (no matter how trivial or important they may seem).

IIABA believes the most efficient, effective, and sensible way to address the licensing and marketplace access problems discussed above is through the NARAB II legislation that has twice passed the House of Representatives. This legislation has once again been introduced in this Congress by Reps. Neugebauer (R-TX) and David Scott (D-GA). The current bill, H.R. 1112, has nearly 60 bipartisan cosponsors. The measure has enjoyed broad industry and strong bipartisan Congressional support in the past as well.

The NARAB II proposal would immediately establish the National Association of Registered Agents and Brokers and provide agents and brokers with a long-awaited vehicle for obtaining and maintaining licenses on a multistate basis. It would eliminate barriers faced by agents who operate in multiple states, establish licensing reciprocity, and create a one-stop facility for those who require nonresident licenses. The bipartisan bill benefits policyholders by increasing marketplace competition and consumer choice and by enabling insurance producers to more quickly and responsively serve the needs of consumers.

H.R. 1112 ensures that any agent or broker who elects to become a member of NARAB will enjoy the benefits of true licensing reciprocity. In order to join NARAB, however, an insurance producer must be licensed in good standing in his/her home state, undergo a criminal background check (long a priority of state insurance regulators), and satisfy the independent membership criteria established by NARAB. These criteria would include standards for personal qualifications, training, and experience, and – in order to discourage forum shopping and prevent a race to the bottom – the bill instructs the board to “consider the highest levels of insurance producer qualifications established under the licensing laws of the states.”

NARAB’s simple and limited mission would be to serve as a portal or central clearinghouse for license issuance and renewal. The bill discretely utilizes targeted congressional action to produce marketplace efficiencies and is deferential to states’ rights at the same time. H.R. 1112 merely addresses marketplace entry and leaves regulatory authority in the hands of state officials. The proposal does nothing to limit or restrict the ability of state regulators to enforce state marketplace and consumer protection laws. State officials will continue to be responsible for regulating the conduct of producers and will, for example, investigate complaints and take enforcement and disciplinary action against any agent or broker who violates the law. In short, the NARAB II proposal would strengthen state insurance regulation, reduce unnecessary redundancies and regulatory costs, and enable the industry to more effectively serve the needs of insurance buyers – and it would achieve these results without displacing or adversely affecting state regulatory oversight.

Conclusion

The Independent Insurance Agents and Brokers of America thanks the subcommittee for its efforts – past and present – to implement tangible and effective marketplace improvements. We appreciate your focus on ensuring that the surplus lines reforms and Federal Insurance Office provisions of the Dodd-Frank Act are implemented as intended, and we particularly look forward to working with you on the much-needed NARAB II proposal in the near future.