

# **Testimony of J. Lee Covington II**

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**Before the United States House of Representatives  
Committee on Financial Services  
Subcommittee on Capital Markets, Insurance and  
Government Sponsored Enterprises**

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Chairman Oxley, Chairman Baker, Ranking Member and Members of the Committee:

Thank you for the invitation to testify before your Committee today on the important issue of insurance regulatory reform. I express my deep appreciation for your past courtesies to me during my service as Ohio Insurance Director and the outstanding support and working relationship I had with you and your tremendous staff. We worked very successfully on Gramm-Leach-Bliley, the Financial Services Fraud Network Act of 2001, the Terrorism Risk Insurance Act, and other important legislation. It is very good to be with you again.

I am testifying today in my capacity as the former Director of the Ohio Department of Insurance and my views do not necessarily represent those of PricewaterhouseCoopers or our clients. I am not a Certified Public Accountant (CPA) and my testimony will not address any matters related to the standards governing CPAs as adopted by the American Institute of Certified Public Accountants (AICPA) or the Public Company Accounting Oversight Board (PCAOB). I will not be not advocating client positions or PricewaterhouseCoopers' positions during my testimony.

I have had the pleasure of working with the Committee during the development of SMART providing high level policy and structural insights and technical assistance on specific issues addressed in SMART. I appreciate the opportunity work with you and my former colleagues to ensure insurance consumers have necessary regulatory protections, consumer choice, and competitive markets inuring to their benefit, as well as assuring a

reasonable regulatory environment for companies and agents delivering vital insurance products and services to policyholders.

As you know, the National Association of Insurance Commissioners (NAIC) began a renewed and very close working relationship with the Committee after passage of Gramm Leach Bliley (“GLB”), beginning in early 2000, with the NAIC’s adoption of its Statement of Intent—The Future of Insurance Regulation. During the past 5 years, NAIC, National Council of Insurance Legislators (NCOIL) and National Conference of State Legislators (NCSL) have all had great leadership, from the very top of the organizations to the individual members working on the numerous initiatives making up the overall reform plan. My good friend, Commissioner Diane Koken, NAIC President, has not only led individual initiatives, but also has provided strong leadership this year after stepping directly into the Office of President for the NAIC in December 2004. Each organization has had an unprecedented level of commitment, focus, work, and energy throughout this time period. I know this because I was heavily involved in many of the initiatives, I know how much time I was devoting to the work and I know how much time and staff others have been devoting to these efforts. The current and past efforts of these organizations are really remarkable.

Significant progress has been made on a number of the initiatives contained in the original Statement of Intent, including developing and operationalizing the National Insurance Producer Registry (NIPR), as required by the NARAB provisions of GLB; enhancing and deploying SERFF, now used in 51 jurisdictions, with 41 and 44 states, respectively, now accepting all major lines of business for life and property and casualty products, and an average review time of 30 days for 72% of filings; and adopting the Interstate Compact Model Law in December 2002. I am sure other witnesses will identify additional areas of important progress.

For very understandable reasons, other initiatives have been slower in development and implementation, and the effectiveness of some initiatives as currently operationalized remains unclear. For example:

- While addressed in the Statement of Intent in 2000, recognizing Market Conduct is one of the most difficult issues for which to develop legislation, the NAIC/NCOIL Market Conduct Surveillance Model Law was approved 4 years later in September 2004. To my knowledge, only one state has adopted any version of the Model.
- The Property and Casualty Commercial Rates and Policy Form Model Law, adopted in 2002, which incorporates a competitive rating system for commercial lines insurance based on actuarially sound principles, has not been adopted or introduced in any state, for many if not all of the reasons outlined in Former Commissioner Nat Shapo's written testimony.
- The NAIC has developed several market conduct operational initiatives aimed at allocating regulatory resources to key regulatory issues, using market analysis techniques and tools to identify companies having a greater likelihood of regulatory non-compliance, and coordinating regulatory examinations to efficiently use resources, eliminate examination duplicity and minimize undue burden on companies. These include the Market Conduct Annual Statement, the Market Conduct Analysis Handbook, Uniform Examination Guidelines, and Standardized Data Calls. While these have been implemented by some states and show much promise, the number of states adopting these initiatives and the impact of these initiatives remains unclear with respect to achieving the goal of an efficient and effective national state-based market conduct surveillance process.

After all the efforts to institute regulatory reforms over the past 5 years, regulators, legislators and other stakeholders widely recognize the challenges and obstacles to achieving reform, which include:

- **Collective Action Issue:**  
The NAIC consists of more than 50 state Insurance Commissioners and their staff working through over 100 committees and working groups. The development of model state laws and initiatives through its consensus process takes substantial time, something all of your members have experienced in Congress. Once the NAIC and/or NCOIL adopt a model law, then it must be adopted by individual states legislatures which have their own diverse priorities, interests and time frames. In the end, the NAIC has no authority to pass its Model Laws and the challenge of seeking adoption by individual state legislatures is substantial, even with the strong support and work of NCOIL and NCSL.
  
- Lack of industry effort to move certain bills, which may stem from numerous possibilities, such as known priorities of individual state legislatures, known positions of individual state legislatures, or lack of support for a particular model.
  
- Continued proliferation of unwritten rules, known by most as “desk drawer” rules and lack of execution according to the intent of a particular model law or reform initiative.

Based on the Ohio experience, even with these barriers, necessary reforms can be implemented. Ohio has done it. With respect to Speed to Market, during my tenure, we implemented SERFF in 2000, in approximately 30 days, and today, over 40% of all filings are submitted via SERFF with an average review time of 15-20 days. Ohio was the first state to implement a reciprocal agent licensing system incorporating NIPR where agents could be electronically fingerprinted, tested and licensed within 5 days and simultaneously licensed in all NIPR states. Ohio was one of the first states, if not the first, to use market analysis data calls to focus resources on companies having the

greatest likelihood of regulatory non-compliance with respect to key regulatory requirements. Regarding financial surveillance, Ohio was the first state to develop and use a CARRMELS prioritization system, similar to the ratings used by federal banking regulators and now used by the NAIC; Ohio was the first to implement a risk focused approach to financial examinations, long used by federal banking regulators; and Ohio was the first to coordinate the examination of companies within an insurance holding company structure. Ohio was also one of the pilot states for CARFRA.

While no new measures were implemented with respect to rate filings, Ohio has long embraced a competitive rating system based on sound actuarial principles, and as a result, Ohio citizens consistently enjoy homeowners rates ranking from the 2<sup>nd</sup> to 5<sup>th</sup> best in the country and automobile rates ranking between 14<sup>th</sup> and 17<sup>th</sup> best in the country.

With regard to the current rate and form review process, Former Illinois Insurance Director Nat Shapo will be speaking in more depth about competitive rating, but some background may be helpful. In December 2000, the NAIC Speed to Market Working Group adopted a Report recommending a “no filing” system or “informational only” filings for most commercial lines rates and forms, with a limited number of products and rates to be subject to regulatory review or with a review required when the Commissioner makes a formal finding that a non-competitive market exists. In Spring 2002, based on this report, the NAIC adopted the Property and Casualty Commercial Rate and Policy Form Model Law. While a very limited number of states have enacted incremental reform, no state has enacted the NAIC Model.

With respect to personal lines rates and forms regulation, with the exception of independent reform efforts in New Jersey, South Carolina and Louisiana, the status quo for rate and form regulation remains intact. On this issue, unlike others, the NAIC has not been able to obtain consensus about moving to a more market-oriented system of regulation. When I left my position as Insurance Director in Ohio, little interest existed among regulators to even address the issue.

In Ohio, for homeowners insurance, consumers enjoy an average savings of \$160-170 compared to the national yearly premium average of \$535. For automobile insurance, they enjoy approximately \$170 in average savings compared to the national yearly premium average of \$775. These savings would be substantially more when compared to states with price control rate regulatory schemes. Competition works, and I am pleased, Mr. Chairman, that you and your Committee continue to pursue a competitive insurance marketplace that benefits consumers.

Most, if not all, insurance regulatory stakeholders agree reform is needed, and the debate is about how, by whom and under what timeframe reform should be accomplished. Commissioner Koken, in her usual eloquent and thoughtful opening address during the NAIC's Summer Meeting, reinforced that we all have the same goals and the discussion should be about process and procedures.

To this end, fair questions for this Committee to consider include:

- Whether the states will ever be able to overcome the collective action issue and adopt completely and uniformly the necessary model laws to achieve reform?
- How long will it take the states to complete this work?
- If the necessary model laws are actually adopted, will states ever be able to operationally coordinate their work, as intended, when executing their duties under those laws?

SMART provides the opportunity for States to maintain a state based regulatory system with needed reforms. While some may object to the preemption provisions, which should only be used as a last resort, the question exists as to what other options do policymakers have if the states cannot institute the agreed upon reform initiatives.

Mr. Chairman and Members of the Committee, thank you again for a very positive working relationship in the past. I look forward to continuing to work with you and my friends and former colleagues at the NAIC to assure SMART meets our common goals of

necessary consumer protection, consumer choice, and competitive markets that benefit consumers. I look forward to answering your questions.