INSURANCE PRODUCT APPROVAL: THE NEED FOR MODERNIZATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON
FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JUNE 21, 2001

Printed for the use of the Committee on Financial Services

Serial No. 107–28

U.S. GOVERNMENT PRINTING OFFICE
73–741 PS WASHINGTON : 2001

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
MARGE ROUKEMA, New Jersey, *Vice Chair*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
BOB BARR, Georgia
SUE W. KELLY, New York
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
CHRISTOPHER COX, California
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LaTOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSELLA, New York
GARY G. MILLER, California
ERIC CANTOR, Virginia
FELIX J. GRUCCI, Jr., New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

JOHN J. LaFALCE, New York
BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIÉRREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
BARBARA LEE, California
FRANK MASCARA, Pennsylvania
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD, Jr., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missiouri
STEVE ISRAEL, New York
MIKE ROSS, Arizona

BERNARD SANDERS, Vermont

Terry Haines, Chief Counsel and Staff Director

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

RICHARD H. BAKER, Louisiana, *Chairman*

ROBERT W. NEY, Ohio, *Vice Chairman*
CHRISTOPHER SHAYS, Connecticut
CHRISTOPHER COX, California
PAUL E. GILLMOR, Ohio
RON PAUL, Texas
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
BOB BARR, Georgia
WALTER B. JONES, North Carolina
STEVEN C. LATOURETTE, Ohio
JOHN B. SHADEGG, Arizona
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
VITO FOSSELLA, New York
JUDY BIGGERT, Illinois
GARY G. MILLER, California
DOUG OSE, California
PATRICK J. TOOMEY, Pennsylvania
MIKE FERGUSON, New Jersey
MELISSA A. HART, Pennsylvania
MIKE ROGERS, Michigan

PAUL E. KANJORSKI, Pennsylvania
GARY L. ACKERMAN, New York
NYDIA M. VELÁZQUEZ, New York
KEN BENTSEN, Texas
MAX SANDLIN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
FRANK MASCARA, Pennsylvania
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
JAY INSLEE, Washington
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
STEVE ISRAEL, New York
MIKE ROSS, Arizona

CONTENTS

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

INSURANCE PRODUCT APPROVAL: THE NEED FOR MODERNIZATION

THURSDAY, JUNE 21, 2001

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The subcommittee met, pursuant to call, at 2:00 p.m., in room 2128, Rayburn House Office Building, Hon. Richard H. Baker, [chairman of the subcommittee], presiding.

Present: Chairman Baker; Representatives Shays, Oxley, Biggert, Hart, Rogers, Kanjorski, Bentsen, J. Maloney of Connecticut, S. Jones, Capuano, Sherman, Meeks, Inslee, Moore and Lucas.

Chairman BAKER. I would like to call this hearing of the Capital Markets Subcommittee to order and invite all of our witnesses to please take seats at the witness table. I'm advised that Members are on their way to the hearing and in order to facilitate progress, we'll go ahead with opening statements at this time.

Today marks the second in a series of hearings the subcommittee has undertaken with regard to reform of insurance.

Our current hearing focuses on the need to modernize product approval processes. Unlike the rest of the financial services industry, insurers are subject to a patchwork quilt of State regulatory requirements.

In many States, insurance products are not only subject to prior approval of the form language, but also to strict regulation of the price and the appropriate rate. These result in time delays in form and rate approvals that vary widely from State to State.

A national rollout of a new product across all 50 States can literally require many years. Why should consumers have to wait for the lowest common denominator in order to have access to a new and desirable product?

Consumers in all States are being harmed, in my opinion, by this excessive regulatory bureaucracy; and in the worst States, such as the unfortunate case of Louisiana, it makes it difficult to get approvals at all.

In fact, I would like to enter into the record, at this point, a letter from my own Acting Commissioner in Louisiana, and quote just a couple of lines:

"The bottom line is that insurance companies are leaving Louisiana because of the prior approval system that is overseen by a politically appointed board. The system is clearly slowing down the speed with which companies can respond to the marketplace and the system must be changed.

"This is why the Louisiana Department of Insurance has worked with the industry and consumers to develop a move to a file-and-use system. Such a system adds speed to the ability to market approval of product and services.

"We, at the Department of Insurance, are committed to continuing our efforts to remove barriers and the restrictions to competition in the Louisiana insurance marketplace."

[The information referred to can be found on page 56 in the appendix.]

And I suspect that the Acting Commissioner's perspectives are not unique. In a review of data of approval times required on a particular product line, unfortunately Louisiana's approval timeline was the worst in the country.

I am also told that approximately 16 companies during the first 6 months of this year have withdrawn from the Louisiana market because of the product and form approval delays.

One company doing business in the State has reported an average approval delay amounting to 305 days for a new liability insurance product. That's really unacceptable.

A bill reforming product regulation is currently moving through the legislative process in Louisiana, and I'm hopeful of its passage.

In New Jersey, just last week, the biggest automobile insurer, State Farm, decided to pull out of that market because the rate reviews had become so onerous and, in their opinion, politicized.

It's reported that since September of 1999, State Farm lost almost a quarter of a billion dollars cutting the company's net worth there in half. Just this week, one of the largest insurers in the world, AIG, also decided to exit the New Jersey market due to the regulatory environment.

As a result of these decisions, in excess of one million New Jersey drivers will need to find new coverage in a very difficult market. That is more than one out of every five drivers in the State.

Today, the fourth largest writer of automobile insurance in New Jersey, Liberty Mutual, is also talking about abandoning the automobile market. That would add an additional half million drivers to the uninsured list.

In fact, according to figures provided by the American Insurance Association, 27 States with very stringent price controls were the most expensive States for the auto insurance consumer with annual expenditures averaging well in excess of $600.

The States are not without some success stories, however. Colorado and Michigan are known for their efficient review and approval of new and diverse products.

Illinois has been successful. In Illinois there are more insurers competing for business, giving consumers more choice at relatively low cost and there are fewer uninsured motorists.

Wisconsin has also had similar results.

Of course this begs the question: Why are those States not being used as models for reform? I am anxious to hear how the National Association of Insurance Commissioners and the National Conference of Insurance Legislators have reviewed this matter, and what are their findings.

The bottom line, as we all know and recognize, is that reform is dramatically needed. I would like to express my appreciation to both panels of witnesses here who are appearing today for their willingness to come forward. I have reviewed the testimony, and I believe it gives excellent insight into the significance of this problem.

I would also express my appreciation to Chairman Oxley for his leadership in this subject matter. He has joined us here today.

I recognize Mr. Kanjorski at this time for his opening statement.

[The prepared statement of Hon. Richard H. Baker can be found on page 54 in the appendix.]

Mr. KANJORSKI. Thank you, Mr. Chairman, for the opportunity to comment before we begin the hearing on the insurance product approval process and the need for modernization.

I commend you and your continued interest in the current issues affecting the insurance industry and your commitment to educating the Members of our subcommittee about these matters.

Presently, a tangled web of regulations often slows the ability of insurance companies to introduce new products nationwide, to the pace of baby steps. This sluggishness in new product and rate approval by insurance regulators frequently creates competitiveness concerns for insurance companies.

The insurance industry has consequently contended, for a number of years, that we need to design and implement a new regulatory system to straighten out the regulatory maze, better the quality and timeliness of filing reviews, and improve competition.

If sensibly put into practice, these actions should ultimately benefit consumers by increasing their choice of and lowering their rates for insurance products.

The National Association of Insurance Commissioners has created its “Speed To Market Working Group” to respond to these concerns.

This group, as I understand, is seeking to develop and implement State-based uniform standards for policy, form, and rate filings for appropriate product lines.

The NAIC hopes that this initiative will shorten the length of the prior approval process and lower the cost involved in reviewing and improving rates and policy forms in the States and territories.

As part of the initiative, the NAIC has divided its work among two subgroups. They are the Improvements To State-Based Systems subgroup, and the Coordinated Advertising Rate and Form Review Authority subgroup, otherwise known as CARFRA.

CARFRA is working to streamline the review process for rates and forums, particularly for life and health products. CARFRA hopes one day to provide insurers with single point of product filings and establish a coordinated regulatory review process among insurance regulators.

Currently, ten States, including my own State of Pennsylvania, are piloting a CARFRA project and NAIC hopes to launch the system nationally by May of next year.

In my view, the need to update and streamline our Nation’s insurance regulations and laws have become increasingly apparent, especially in the wake of the 1999’s law to modernize our national financial services industry.

Not surprisingly, our current insurance regulatory system, with more than 50 separate jurisdictions, often delays the nationwide introduction of new products.

Executives at some insurance companies have previously noted that it can take 18 months or longer to obtain the necessary approvals to sell a new insurance policy or annuity on a national basis.

In our dynamic economy, rare is it that the slow are rewarded. The insurance industry is certainly no exception to this rule.

We should consequently work to improve the efficiency and effectiveness of the regulatory system for insurance in the months ahead. I will therefore continue to keep a watchful eye on NAIC's speed to market initiative and examine its effects on both companies and consumers.

We may additionally need to pursue complementary reforms in the insurance industry at the Federal level.

It is also my sincere hope that as we continue in our efforts to modernize insurance regulation, we will work to provide adequate and appropriate safeguards to protect the interests of individual consumers.

In closing, Mr. Chairman, I believe it is important that we learn more about the views of the parties testifying before us today and, if necessary, work to further refine and improve the legal structures governing our Nation's insurance system.

[The prepared statement of Hon. Paul Kanjorski can be found on page 59 in the appendix.]

Chairman BAKER. Thank you, Mr. Kanjorski.

Chairman Oxley.

Mr. OXLEY. Thank you, Chairman Baker, and thanks for holding this important hearing today on speed to market issues.

I'm pleased that this subcommittee is reviewing the need for modernization and reform in our current system of insurance product approval.

Insurers are subject to the jurisdiction of over 50 different State regulators, each with its own set of rules and regulations. Companies have to navigate their way through a mind-numbing maze of conflicting regulatory requirements to offer products to consumers.

The current patchwork system for insurance regulation imposes significant unnecessary costs on insurers and results in unnecessary delays in getting new products to market.

Ultimately, the consumer bears the cost of this bureaucratic morass facing higher prices and product unavailability.

Other financial industries in the United States, such as banking and securities, do not face significant delays. Those products get approved either immediately or for some securities products, within a few months.

In contrast, companies trying to plan a nationwide rollout for new insurance products have sometimes faced delays of up to 2 years. That is simply unacceptable.

Over the last several years, I've asked the National Association of Insurance Commissioners to focus on this glaring problem. By all accounts, the NAIC has made some progress and I applaud their efforts.

In particular, I'd like to thank the director of insurance for my home State of Ohio, Lee Covington, who has been a great leader for the NAIC on State-based reform of the product approval process.

I would also like to commend Commissioner Fitzgerald of Michigan. Both Commissioners have agreed to join us today to report back on the NAIC's efforts.

Make no mistake about it, true reform is clearly necessary. It is my hope that our State legislators and insurance commissioners can enact such reform.

If not, Congress will return to this issue with our own solution.

While the NAIC has moved ahead with two initiatives, one for life insurance and one for property casualty insurance, the jury is still out on the effectiveness of these programs.

In fact, we will hear from a number of witnesses today who will say these initiatives don't go far enough and are a long way from reforming the system.

Mr. Chairman, I appreciate your continued leadership on this subcommittee to help us understand the problems facing the insurance industry and insurance consumers.

I look forward to the subcommittee's continued work in this area and I yield back the balance of my time.

[The prepared statement of Hon. Michael G. Oxley can be found on page 57 in the appendix.]

Chairman BAKER. Thank you very much, Mr. Chairman.

Mr. Bentsen or any other Member.

Mr. BENTSEN. Thank you, Mr. Chairman.

Mr. Chairman, I want to thank you for holding these hearings. This is my seventh year on this subcommittee and I can remember when I was first on this subcommittee and we struggled with the battles between the insurance industry and the banking industry, and I think as we see, with the passage of the Gramm-Leach-Bliley Act, along with the continued integration of the American economy and the disintermediation of the American financial sector as it relates to consumers, that these types of issues are going to continue to rise to the top.

And I think that this subcommittee is going to find itself confronted more quickly, or sooner rather than later, with some need to balance both a Federal uniform standard, whether it is bringing product to market, or how regulation comports with other Federal financial regulators, and what the State regulators are able to do in the structure they have under the NAIC.

And I would also say that we will find ourselves, as we have in the past, struggling to balance protecting what remnants there are of McCarran-Ferguson, and ensuring that there is sufficient consumer regulation and parity at the State level, at the same time, in trying to achieve those uniform standards.

I know the Chairman and the Ranking Member are well-versed and have been through many of these battles as has the Chairman of the Full Committee, and what is, I think, most interesting and perhaps maybe most telling in what action we take, is that these battles used to be fought across the hallway and now you've got Members of both Committees sitting on the dais here today, and that hopefully will hasten us to find the most appropriate approach to trying to address this continually vexing problem that this subcommittee, at least the predecessor subcommittee, has tried to deal with.

And I thank the Chairman for calling the hearings.

Chairman BAKER. Thank you, Mr. Bentsen.

Ms. Biggert.

Mrs. BIGGERT. Good afternoon and thank you, Chairman Baker, for holding this hearing. Globalization, rapid technological change and comprehensive financial services reform all have conspired to change dramatically the marketplace for insurance products in the United States.

In light of these changes, I think we can all agree that it's time to bring insurance regulation into the 21st century to ensure continued product innovation, enhance competition, and better serve the customer.

Insurance rate deregulation, in my home State of Illinois, is an example of a system that has worked well, not just for regulators and insurers, but most importantly for the consumer.

Let's look at what a system with no rate regulation has produced. Illinois has a very small residual market and significantly more auto and homeowners insurers competing for business than States with stringent regulation.

The premiums and loss ratios in Illinois are well below most other States with large populations, allowing State regulators to initiate other innovative safeguards, such as early warning systems and computerized market conduct exams.

In short, let me put all parochial interests and personal bias aside and objectively state that Illinois has one of, if not the most, efficient systems in the country.

Rate regulation works in Illinois and it has worked very well for nearly 30 years. My hope is that Illinois can serve as a model for other States that want to serve consumers better.

On the subject of form regulation, Illinois is not quite as special, and no matter how special any State may be, the problem is that there are 50 of them and that continues to present challenges for insurers servicing customers in multiple States.

Each State has its own set of rules, procedures, and interpretation for whether a new insurance form or policy can pass.

The consequences often hurt the consumers most. Consumers should have access to new products, competitive prices and choice, and we must modernize the current regulatory system to ensure that they do.

Today's hearing provides a great opportunity to highlight what works and what doesn't work. I think all the witnesses here today, and especially my fellow Illinoisans, State Representative Terry Parke, the President of the National Conference of Insurance Legislators; Ms. Rita Nowak, Alliance of American Insurers; and Mr. Phil O'Connor, the former Illinois Director of Insurance.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman BAKER. Thank you, Mrs. Biggert.

Mr. Capuano, did you have a statement?

Mr. Inslee.

Mr. Shays.

Mr. SHAYS. Thank you.

Just to welcome our witnesses. I appreciate them being here today. And thank you for calling the hearing.

Chairman BAKER. Mr. Rogers.

Mr. ROGERS. Thank you, Mr. Chairman.

I appreciate the opportunity.

I want to thank Frank Fitzgerald, Michigan's Insurance Commissioner. I had the great privilege to serve with Mr. Fitzgerald in the State legislature where he distinguished himself, and continues to do so in the role of Insurance Commissioner in Michigan.

We appreciate it. He hass led the charge for modernizing pricing and regulation of commercial lines, and I look forward to your comments today, sir.

Michigan is leading the way under your leadership and the leadership of John Engler in Michigan, and we certainly appreciate your being here today and the work you're doing in Michigan.

Thank you.

Chairman BAKER. Thank you very much.

We would like to now call on our first tag team. I understand by prior agreement, we have a division of time between the two distinguished commissioners, the Honorable Frank Fitzgerald, Commissioner of the Michigan Insurance Bureau, Office of Financial and Insurance Services, and the Honorable Lee Covington, Director, Ohio Department of Insurance on behalf of the National Association of Insurance Commissioners.

We would recognize each of you for 3 minutes to make opening statements. Please be aware, all witnesses, your full statement will be incorporated as part of the record.

Feel free to summarize and we would like to, as best possible, have the statements of the other witnesses be under 5 minutes to allow Members to have as many questions as possible.

Thank you for appearing here today.

Mr. Fitzgerald.

STATEMENT OF HON. FRANK M. FITZGERALD, COMMISSIONER, MICHIGAN INSURANCE BUREAU, OFFICE OF FINANCIAL AND INSURANCE SERVICES; CHAIR, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS FINANCIAL SERVICES MODERNIZATION TASK FORCE

Mr. FITZGERALD. Mr. Chairman, thank you and thank the Members for holding this hearing today and giving the National Association of Insurance Commissioners an opportunity to discuss the very important reform steps that have been taken over the past 15 months.

Chairman BAKER. If I could just trouble you to pull the mike a bit closer, we can hear you a little better.

Mr. FITZGERALD. Thank you.

It was in March of 2000 that the NAIC adopted the Statement of Intent: The Future of Insurance Regulation. At that time, nine working groups were established and I was asked, along with Commissioner Diane Copland of Pennsylvania, to co-chair a working group entitled "Speed to Market".

How could products, the rates, and the forms come to market more quickly, but with sufficient consumer protections in place and hopefully at less cost for the companies and ultimately for the consumers.

This is a big challenge, but it's one that I believe that we are meeting. In the past 8 months, the NAIC has established the Coordinated Advertising Rates and Forms Review Authority or CARFRA, in a limited launch phase, to show that, in fact, the States can come together, develop national standards for products, list where there are deviations under State law from those national standards and work to eliminate those, and allow a company to come to CARFRA, enter a single door literally through a computer, and within 45 days, come out of that door and be able to use that product in all of the States that participate in CARFRA and that participated in the approval of that product.

We, on May 1st, began the operation of CARFRA. We have received our first filing under CARFRA, and through the course of the summer expect to receive more.

Although we have only ten States and three products involved at the current time, that was done purposefully, because what we want to do is know that the procedure can work, and we believe very much that it will, and then, beginning this fall, expand the number of States and expand the number of products that are involved.

So that approximately a year from now, we would have a working CARFRA mechanism that would allow all 51 jurisdictions in the United States, including the District of Columbia, to participate.

This will dramatically speed the delivery of products to the marketplace, will reduce the cost that goes into getting the products there and, at the same time, will allow consumers to receive the highest possible oversight.

This is an unprecedented step in the over 130-year history of State regulation of insurance. It's the first time that national standards have been developed, the first time that we have a coordinated State approach to this sort of approval.

We believe that over the coming months, we will, as insurance regulators, demonstrate that this will work. We have the support, especially of the life insurance industry, which has very much asked for this. We will work forward to include all States and the District of Columbia in this process.

We thank the subcommittee for the opportunity to talk about this, and I look forward later to the questions that the Members might have.

Thank you.

Chairman BAKER. Thank you very much. We appreciate your courtesy, sir.

Mr. Covington.

STATEMENT OF HON. LEE COVINGTON II, DIRECTOR, OHIO DEPARTMENT OF INSURANCE; ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. COVINGTON. Chairman Baker, Members of the subcommittee, I serve as Chair of the Speed To Market Improvements, a State-based systems working group.

As the subcommittee has recognized in its opening statements, insurance regulators also recognize that historically it has taken far too long to introduce new insurance products in all 50 States. This is not good for consumers, it is not good for the industry.

Commissioner Fitzgerald just talked about the CARFRA proposal. The Improvements To State-Based Systems initiative addresses speed to market for products not reviewed by CARFRA, including most property and casualty products at this point.

The Improvements To State-Based Systems plan, adopted in December, calls for a 30-day period of time for an introduction of products on a nationwide basis, and 60 days under exceptional circumstances.

And also implementation of what is most commonly referred to as an informational or competitive rating system for most commercial lines' rates.

The plan squarely addresses most, if not all, concerns relating to product filing procedures by adopting three major best practices or operational efficiencies currently used by many States.

First, the creation of review standard checklists by every State in a common format that will be accessible to the NAIC's central website.

The State of Colorado estimates that after institution of review standards checklist, over 90 percent of their insurance products complied, were filed with the department, complied with the law, and were able to be introduced within a 30-day period of time, up from 20 percent compliance before the implementation of these review standard checklists.

In just 5 months since release of the plan, it was adopted in December, a common format was created in over 28 States representing 60 percent of the United States' insurance property and casualty market. These States report 100 percent completion of the checklist, and those checklists will be completed by the end of June to mid-July.

And we continue to receive reports that additional States will be completed by that time period.

Particularly it is important to note that 14 of the 17 largest States have reported that they will be completed by mid-July.

New Jersey, the ninth largest insurance market, is over 50 percent complete at this point. We are well on our way to our goal of having all States completed in 2001.

In addition to that, the plan calls for implementation of an electronic filing system in all States. We call it the System for Electronic Rate and Form Filing (SERFF) system. Currently, the NAIC's plan calls for active filing status in at least 41 States by the end of the year, with remaining States to be added in 2002.

Twenty-four States are accepting filings currently and 23 States are in the testing phase.

SERFF will allow us to be able to monitor the performance of States and of insurance companies. And finally we want to work to create greater uniformity.

I've already talked about the commercial lines area, the plan for that. And in addition to that, this year we are working on personal lines, and have already had one meeting where we had 18 panelists testify before the NAIC, and we will continue that work throughout the summer and through the remainder of this year.

Thank you, Mr. Chairman, for the opportunity to be here, and I'll be glad to answer any questions.

[The prepared joint statement of Hon. Frank M. Fitzgerald and Hon. J. Lee Covington II can be found on page 61 in the appendix.]

Chairman BAKER. Thank you very much. We appreciate your testimony, sir.

Our next witness is the Honorable Terry Parke, Illinois State Representative, and President of the National Conference of Insurance Legislators, who is here on behalf of the National Conference of Insurance Legislators.

STATEMENT OF HON. TERRY PARKE, ILLINOIS STATE REPRESENTATIVE; PRESIDENT, NATIONAL CONFERENCE OF INSURANCE LEGISLATORS, ON BEHALF OF THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

Mr. PARKE. Thank you Chairman Baker and Members of the subcommittee.

Again, I am State Representative Terry Parke. It is my privilege to serve as President of the National Conference of Insurance Legislators or NCOIL. NCOIL is a organization of State legislators whose primary public policy concern is insurance and insurance regulation.

Since its inception more than 30 years ago, NCOIL has supported State regulation of the business of insurance as authorized by Congress in the McCarran-Ferguson Act.

The States have established a strong record under that organization. Insurance markets have grown and have become increasingly competitive in terms of price and products.

NCOIL legislators are ready to do what it takes to build upon that record. NCOIL recognizes that there is no escape from the fact that powerful technological and competitive forces challenge the State-by-State system of insurance regulation.

NCOIL supports the efforts of the National Association of Insurance Commissioners to bring about needed efficiencies in the State-based system.

NCOIL supports the NAIC Statement of Intent of March 2000, which outlines a plan for the future of insurance regulation under the Gramm-Leach-Bliley Act of 1999.

That statement and the NAIC's efforts since then have addressed, among other things, the need to speed and synergize the State-by-State process of policy form and rate approvals, the need for speed to market, and that is the focus of this hearing.

The NAIC has conceived and put into motion a voluntary plan to facilitate one-stop shopping for price and product approvals. The NAIC has initiated a trial run or limited launch of the plan, known as the Coordinated Advertising Rate & Form Review Authority, or CARFRA, in ten States.

NCOIL could support efforts to take this laudable NAIC effort one important step further. That step would overcome the fact that CARFRA is voluntary, that its opinions are advisory, and that it allows individual States to retain their own authority.

NCOIL could support efforts aimed at a totally independent State-based regulatory facility. Its purpose could be to decide on policy form and rate approvals.

Such an entity would have absolute authority, take its authority directly and totally from State governments and be totally State-based and State-funded.

Its strength would lie in its power to make fast, effective and final decisions. Its success, we recognize, may require some ceding of State authority, possibly through an interstate compact or other means.

NCOIL has long advocated interstate compacts. But your subcommittee, Congress, and all interested parties should view a compact not as an end in itself, but rather as a tool to achieve a greater goal. That of course would not be the only option.

Among other options would be to let the market prove itself as a regulator. Any such move would, of course, require the presence of adequate solvency safeguards to protect against any self-destructive or overly competitive behavior. It would also require aggressive policing of the insurance marketplace with adequate punishment of any abusive sales and claims-paying practices.

A market approach can work. I am proud to say that Illinois has put its faith in the market since 1971. Illinois consumers have benefited from overall premium rate levels that are below most other States with high populations and heavy traffic.

Auto insurance is readily available in the private market in Chicago. The residual market is small. Nationwide surveys indicate that the percentage of uninsured motorists is below the average of other populous States.

Other studies show that more auto and homeowner insurers are competing for business in Illinois. Illinois has more than doubled the number of competing insurers than States like Massachusetts and New Jersey, States that have price controls.

States have begun moving toward a market solution. NCOIL has adopted a commercial lines deregulation model act in 1999. Since 1995, 22 States have instituted some form of commercial lines are and form filing deregulation.

Less than one month from now, NCOIL will consider a comprehensive deregulation bill that would establish a competitive use and file system in States that adopt the measure. It would cover personal as well as commercial lines.

Solvency safeguards are already up and running and they have been for some time. State adoption of NAIC model uniform laws aimed at monitoring the financial strength and claims-paying ability of insurers through an NAIC accreditation program greatly reinforced and improved upon those safeguards. The fact of it is that for more than a century, the record of State insurance regulation compares most favorably with that of the regulation of other financial service institutions.

Significant steps toward improved regulation in the insurance marketplace have begun. NCOIL commissioned a study which identified areas where States need to improve the market conduct examination process. NCOIL is monitoring the process of the NAIC today and the coordination of multi-State market conduct exams, the training of market conduct examiners, and the validity of self-policing.

NCOIL will mark progress in that regard when it holds its public hearing in Chicago on July 12th.

Illinois introduced market conduct examinations in 1970 in tandem with its move to competitive regulation in Illinois. Market conduct examinations evaluate underwriting, advertising, agency operations, marketing, and claims practices.

NCOIL believes that State regulation has served the needs of the families and businesses that buy insurance and has fostered a strong market of financially sound competitive insurers.

Now NCOIL recognizes the need to respond to new challenges and modernize State-based insurance regulation.

NCOIL is more than willing to work with all interested parties to make that happen.

I'm ready to answer any questions, Mr. Chairman.

[The prepared statement of Hon. Terry Parke can be found on page 81 in the appendix.]

Chairman BAKER. Thank you very much. We appreciate your appearance here.

Our last witness on this panel is Mr. William Fisher, Vice President and Associate General Counsel for the Massachusetts Mutual Life Insurance Company, on behalf of the American Council of Life Insurers.

Welcome, Mr. Fisher.

STATEMENT OF WILLIAM B. FISHER, VICE PRESIDENT AND ASSOCIATE GENERAL COUNSEL, MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS

Mr. FISHER. Thank you, Mr. Chairman.

I am appearing today on behalf of the American Council of Life Insurers, ACLI, which has 426 members who account for over 80 percent of the life insurance in force in the United States.

Speed to market is the ability to bring products to the marketplace in a timely and efficient manner, but without sacrificing consumer protections. This is unquestionably one of the most important matters confronting our business.

Chairman BAKER. Mr. Fisher, I'm sorry, could you pull the mike a little closer and we can hear you much better.

Mr. FISHER. In late 1999, the ACLI completed a comprehensive study of the current state of life insurance regulation, which identified speed to market as a highly pressing issue.

I have a copy of that report which I would like to submit for the record.

[The report referred to can be found on page 85 in the appendix.]

Concern about speed to market was reinforced by a February 2000 survey in which ACLI CEOs identified this issue as being the single most important issue in need of reform.

Today, life insurers compete directly with non-insurance financial services institutions, such as banks and mutual funds. The national banks do not need explicit regulatory approval to bring products to market on a nationwide basis, and can be in the marketplace in a matter of weeks.

Securities firms typically get regulatory approval from the Securities and Exchange Commission in a matter of 3 to 4 months. In contrast, life insurance product approvals from all 50 State insurance departments take anywhere from 6 months to 2 years to complete.

The product approval process also involves application of differing State laws, and even where the laws are uniform, differing interpretations, standards and requirements.

Mass Mutual's experience helps to illustrate the problem. In the 52 jurisdictions in which we do business, we have 41 different State versions of our basic universal life product.

For our individual life insurance products, it takes approximately 4 weeks for an experienced person working full time simply to put together a single product filing for all States.

And I have with me the instruction manual that that area uses. It's three inches thick and I think it really demonstrates the problem.

Delays in the product approval process also result in lost opportunities. We estimate that for last year alone, we lost at least $80 million in sales measured by premium due to the inability to get products to market quickly.

This is not however just an insurance company problem. Consumers suffer, because the inability of companies to bring products to market quickly also means that it translates into consumers' inability to obtain the best price or most favorable product features that a company can offer.

Last November, the ACLI released a report entitled "An Optimal Approach To Insurance Product Regulation." The basic points of the optimal structure are: establishment of uniform national standards for products, establishment of a single entity with sole jurisdiction over products, filing of products with a single entity on a file and use system rather than the current prior approval system.

Consumer protection would be continued because filing would require certification of compliance with applicable standards, and enforcement of compliance would be through market conduct examinations. I have copies of that report which I would also like to submit for the record.

Commissioner Fitzgerald and Director Covington have just described the NAIC CARFRA initiative, and let me give you the ACLI view of CARFRA.

While CARFRA, in its initial phase, does not achieve many of the objectives set forth in the ACLI report, the ACLI believes that CARFRA is a significant NAIC accomplishment and a very good first step toward the realization of a broader solution.

Creation of a single point of filing, coupled with a 45-day approval time, is very encouraging. At this point, however, there are a number of practical considerations that limit the benefit of CARFRA.

This pilot phase of CARFRA involves ten States and two products of interest to the ACLI. One important issue relative to the uniform national standards still remains unresolved.

And finally, even with an effort to produce national standards, CARFRA currently involves over 200 deviations per product in the ten pilot States.

That being said, the ACLI recognizes that CARFRA is in a very early stage and making it a success is clearly a long term process. Success will be measured by participation by all States and achievement of true uniform national standards.

This will be a very challenging task, which will require the continued dedicated efforts of NAIC members as well as changes in State legislation.

The ACLI is committed to working with regulators and legislators to achieve that result.

In sum, the financial services marketplace has changed very dramatically in the past years, and our system of insurance regulation has not kept pace.

Immediate and substantial reform is necessary to assure the long-and short-term well being of our business.

I appreciate this opportunity to appear today, and will be happy to answer any questions.

[The prepared statement of William B. Fisher can be found on page 85 in the appendix.]

Chairman BAKER. Thank you very much, Mr. Fisher. We appreciate your participation here today.

I'd like to start with the observation that I think each of you are in agreement that the current model or process presents problems not only to the business interests marketing products, but to consumers who depend on the products for various and sundry reasons.

The issue should be, how do we move more quickly to resolve the problem, and what methodology should be utilized.

For example, the CARFRA 10-State experiment on limited product lines appears to have enjoyed some success, but as Mr. Fisher has just pointed out, there still are an extraordinary number of exceptions to the CARFRA requirements since it, one, is voluntary, and two, the States tend to be protective of their particular orientation on a given matter.

Representative Parke, you indicated that your organization had some concerns about the progress that could be achievable under CARFRA, but does the organization have a model of its own that it sees as responsive in a timely way or an improvement to CARFRA that you might suggest?

Mr. PARKE. Well, Mr. Chairman, I might point out that under the Gramm-Leach-Bliley Act, which was just passed last year, there are a number of triggers that said the States had a responsibility to do it and one of those was the agents licensure where you said that you needed, by November of 2002, to have 29 States pass some meaningful uniform and reciprocity agents' licensing.

I am proud to say that through the NAIC efforts and through the Agents Association, and through NCOIL, we now have exceeded those 29 and are ready.

The NAIC is looking and using CARFRA as an answer. It could be the answer, but we are looking, working with them, trying to figure out other ways to do it. We've talked about interstate compact, which is in many ways similar to what CARFRA is.

What you have to remember is that we now have the responsibility to meet your triggers, which you've established under GLBA. I think we're doing it.

I think if you give the States the opportunity to continue, have hearings, put the pressure on us, we will continue to respond and I think through that, we will come up with the answers that'll be both good for the industry and good for the consumer.

Chairman BAKER. Let me follow up on that point. With regard to the 29 States approval, that doesn't represent a significant portion though of premium dollars written or agents licensed, because we have still have not yet broken into the large insurance markets.

Given that and the subcommittee's attempt to set a trigger that would be acceptable and achievable at the State level, I think there is the recognition on my part that we very much appreciate and have sensitivity to State regulation and enforcement, but that structure has a very difficult time of being totally justified when you have such enormous disparity in local approval requirements, you know, having to have something typed in a certain place facing a certain way.

That is almost back to monastery-type days in handwriting style.

Representative Parke, you seem to indicate that additional hearings would be helpful.

Given the seriousness of this, do we really need to just have hearings, or do we really need to contemplate steps a little more aggressive, or wait until next fall and just see how it all falls out?

Mr. PARKE. I might respectfully say you've set the guidelines. You've told us what the States are expected to do. Now let us do it. Give us the time lines that you've established and say, all right, fine. Let it work, and I believe that the States will respond.

I'm pleased to tell you that on the Governor's desk right now in Illinois, is the agents licensure. We're the fifth or sixth largest insurance producer in the United States. I believe that the Commissioner from Michigan can also speak to it, but I think they are very close.

So we see that there are definitely a couple of major States, Florida, New York, and California, which are large producers of insurance, that are still working on it. We are hopeful that they also will be able to come to the table and pass some meaningful insurance legislation that complies with the GLBA.

Chairman BAKER. Thank you.

Commissioner Fitzgerald, there is significant difference between standardization of forms and reciprocity and then the higher standard of uniformity.

In order for us to have a market that works sensibly, isn't uniformity what we really have to get to?

Mr. FITZGERALD. Uniformity, or a very high level of standardization, I think, is the goal not only of Commissioners, but certainly of the industry, and would benefit the consumers of this country.

One of the great benefits of CARFRA is that, for the first time, we now have a common agreement as to not only what constitutes appropriate national standards for the products that we've begun with, but also what the differences are across the ten States, and that will of course be expanded then to include the other States.

We have felt all along that CARFRA will help serve as a cleansing mechanism for the State legislatures. To see that, in fact, there are many of those, such as the "i" is not dotted in the proper place.

Requirements on the book that do not serve to protect consumers nor benefit the companies can be removed, will be removed.

I believe that over the coming several years, we're going to see a very high level of standardization occur for those products that are a part of the CARFRA process, but importantly, it will also make legislators across the country far more sensitive to the fact that you can have this sort of nationalized system occur and that they can comfortably let go of many of the old rules that in the year 2001 and beyond simply serve no purpose.

Chairman BAKER. Thank you. I have exhausted my time.

Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman.

I'm impressed with the success and the movement of NAIC. What I am worried about though is two things; enforcement, since I understand it is voluntary at this point, and so there really isn't any enforcement mechanism.

But more than that, let me break out, how do you anticipate the rates to operate? Is there going to be a national or a State-by-State rate?

How will this happen?

Mr. FITZGERALD. We think, Congressman, that initially forms will be the area in which the greatest benefit can be had. That over time, I think that through the legislative process, the rate issue is really going to take care of itself.

We are moving in the direction of a much more open rating system where, similar to Illinois, companies can simply go ahead, use rates and allow the marketplace to regulate. And the marketplace can, very efficiently, regulate rates.

The consumer protection that needs to be afforded comes on the forms side, and even Illinois continues to review forms. And that's where we believe, in the long term, the CARFRA concept can best work.

Mr. KANJORSKI. And I agree. I think that in getting uniform policies and processes that are going to work, you are well on your way, and I think we're going to make this not only in the 29 States, but the big ones are going to eventually come in as well.

I'm more interested in what the National Association has done. They put together a great working group and a great organization, but it turns over and it is hardly representative of the people.

It is, in most instances, appointed insurance commissioners of whoever occupies the governor's office at that precise moment, and then on the other end, some are elected. So we have sort of a mishmash. The underlying structure of the organization, is it one-man/one-vote, or one commissioner/one vote?

If 29 of the small States get together, can they order the other 21 larger States to conform to something?

Mr. FITZGERALD. The NAIC does operate on a one State/one territory.

Mr. KANJORSKI. So it's even worse than the Senate?

Mr. FITZGERALD. It operates on a one-person/one vote system. And so, yes, indeed, as you have turnover occur, changes can occur in direction of that organization.

However, I think over the past 15 months, the reform direction that we have launched is so well-established, and the interest of the Congress is so high, that there is simply no going back, and that we will see an acceleration of reform occurring through the NAIC.

And as Representative Parke has testified, I think you're going to find the State legislators beginning to work very actively in this reform and standardization movement.

Mr. KANJORSKI. Let me throw out something that I've been interested in in the last couple of Congresses. We have something kicked around up here known as "catastrophic insurance."

And catastrophic insurance is to cover hurricanes, earthquakes, and tornadoes. I think we leave floods out, because they are too expensive for some reason.

But if you look at where catastrophic insurance is covering, it's covering Florida, Texas, California, and a few of the Midwestern States.

The theory is that we would create a fund, a secondary insurance fund, that would be underwritten by the Federal Government to make the rates sufficient to encourage buyers in these States that are at high risk.

Not a bad policy, but the question is, why should somebody in Kokomo, Indiana, underwrite a hurricane survivor in Miami?

But more than that, the thing that disturbs me is that drive toward uniformity. Sharing the risk conflicts with, sometimes, the free market system of where investments should be made.

If we allow a property risk in Honolulu to be the same as Kokomo, Indiana, and if you're going to invest your dollar, the likelihood of making a profit will be in Honolulu much faster than in Kokomo, Indiana.

In fact, we know from prior experience, hurricanes and other things, the base underwriters of insurance are going to be in Kokomo, Indiana. They're really picking up the additional rate.

What mechanism do we have in the NAIC to cover that problem when it eventually emerges? I know it isn't there yet, but as you go into the ring here, it definitely will occur where there will be people who are picking up the cost of insurance.

I'll throw another quick one out. A recent study indicates that heart conditions are experienced in higher proportions in Appalachia than in other States, having some correlation with economic conditions.

Are we going to end up with a national rate for heart conditions, or we going to have an exclusion if you live in Appalachia, or a higher premium?

So it goes to health insurance, it goes to property damage, and in what way do you envision the NAIC to come to grips with those problems?

Mr. FITZGERALD. I think you've identified a very important point. That is that property and casualty insurance tends to be a much more local undertaking.

In Michigan, we are not much concerned about hurricane protection or earthquake protection. Flooding can be important and ice damming in the winter resulting from heavy snows is very important to us, but not in Florida.

That is why ultimately I think we will probably see a movement across the States toward true deregulation of rates as they pertain to property and casualty insurance, and let the marketplace bear that burden and that risk, so that you don't have somebody in Kokomo, Indiana picking up the tab for a hurricane that has occurred in Southern Florida, for example.

Life insurance, to a great extent, has become deregulated on price, more of a file and use system across the country. There you can have a far greater standardization of rate than with property and casualty products that are more dependent on local activity.

So again, Congressman, I think what we will see is a very fast evolution of State laws that will take into account exactly what you have identified as an issue facing us, and that is how do we have those who face a risk bear that risk most appropriately from a rate standpoint.

Chairman BAKER. If I may, Mr. Kanjorski.

Mr. PARKE. Just one comment, if I may. Congressman I may say that when I get a call on an insurance problem with my constituents, fortunately Congress doesn't deal with it, that's the responsibility of the State. So they call their State representative or State senator. It does not make any difference whether that Commissioner is elected or appointed.

When I have a problem and I can't get the liaison in the insurance department to handle that problem, I'll go directly to the commissioner. I don't care how he got there, he's the source of the answer. And I expect those answers to come from those insurance commissioners. And if I can't get the right answers on a consistent basis, then I go to the governor or the people and try to figure out a way to remove that person so we can get the right person in there.

So to me, it doesn't make any difference if they are elected or appointed. As a legislator, my responsibility is to my consumer who has a problem.

Mr. KANJORSKI. I understand and I agree, but I've been watching some of the States and I notice that very often insurance commissioners who stand for an election tend to take more populist views; sometimes that doesn't comport with the best of sharing the risk.

Chairman BAKER. If I may, Chairman Oxley.

Mr. OXLEY. Thank you, Mr. Chairman.

Director Covington, welcome.

Could you explain to us desk drawer rulings? Indeed, even in a case where you have uniformity of laws, isn't the interpretation of that law critical to try to find some kind of reasonable solution to the issue?

Mr. COVINGTON. Chairman Oxley, we do have a problem with desk drawer rules and what I call ad hoc determinations by departments across the country today.

One of the goals of the review standards checklist that I talked about earlier is to eliminate those desk drawer rules. That's the first step in creating greater uniformity across the country.

In fact, much to my chagrin, we found one desk drawer rule in Ohio and we're going to eliminate that desk drawer rule.

But many States have many desk drawer rules, so it is an issue. The plan that we adopted in December addresses that issue.

Mr. OXLEY. If Congress sets a goal of 3 to 4 years for achieving comprehensive uniformity by NAIC for product approval, do you and Mr. Fitzgerald feel confident you can meet that goal?

Mr. COVINGTON. Chairman Oxley, I think we've got to meet that kind of goal. As we said before, the current system is not good for consumers, it's not good for insurance companies. We must meet that goal.

And I think that we've set in action a plan that will do that. In just over a year, we set a vision for modernizing insurance regulation. We established a plan for doing that. And now we're quickly, at an extraordinary pace, implementing that plan, so I think that's a reasonable timeframe.

Mr. OXLEY. Mr. Fitzgerald.

Mr. FITZGERALD. I agree with that. I think a 3 to 4 year horizon is appropriate for the governors, the legislators, the insurance regulators of this country to work together. We've very clearly identified the issues. We now need to have some time to be able to address those.

If, over the next 2 to 3 years, you haven't seen significant progress, then I think there need to be questions raised about whether we can effectively, at the State level, solve the problems that you have helped identify and that we are identifying.

Mr. OXLEY. Representative Parke, during the testimony back when we were considering Gramm-Leach-Bliley, one of the most effective pieces of testimony came from Illinois in describing the Illinois system. I understand you haven't had re-regulation now for some 30 years in the life insurance side of things, and it's worked quite well for consumers and the industry.

If that is the case, and I assume you would agree that that's the case, why haven't other States adopted that model?

Why hasn't NAIC sought to adopt the Illinois model?

Mr. PARKE. I think that what we have found is that this is a blast across the bow. I believe the insurance commissioners understand now, under GLBA, that you mean business. And quite frankly it's still something that the State legislators in some States have to understand that you mean business.

And I think that many times it's easier to just continue to do what we've done before, there's no need to change, and so therefore many of the regulators and their departments have been there for a long time. They haven't had to do it.

I've gone to any number of NAIC meetings, and I've watched and listened and it's non-stop work from morning till night. And I think that their desire to make sure that the speed in the market is something that really happens, and I think that they have the will and desire. I know the State legislators that are members of NCOIL and we try to bring in the chairmen of the various State insurance committees to educate them on insurance.

I think we're going to get the attention of the legislators in the various States that we mean business, and if we don't do it, then Congress is going to do it for us.

Mr. OXLEY. Thank you for your testimony. I was an original member of what we called the Conference of Insurance Legislators (COIL) back then in the 1970s, and clearly, the organization has come a long, long way, providing great leadership from the State legislative side of the issue and you are to be congratulated for your efforts.

Let me just ask our two Commissioners what their take is on the Illinois model and whether it's being considered in the overall context of the NAIC proposals.

Mr. COVINGTON. Chairman Oxley, as I testified previously with regard to commercial lines insurance, the plan that we adopted in December clearly sets forth a move to a competitive rating system for most commercial lines insurance products.

Right now, there are four States that have a system that is very similar to that plan. Fifteen States had the discretion of their legislative statutes in order to move forward with that plan.

The remainder of States will need legislation.

With regard to personal lines, it does become more complicated, even in Illinois. Even in Illinois, where they do not regulate the rate, they do regulate the classification system. When you look at a product in the rate, there's the rate, there's the classification, and there's the product.

Even in Illinois, they regulate the classification system. So that's one of the issues that we are studying currently as to how to best and most efficiently regulate that classification system, or whether we should regulate it at all.

And that's what we are endeavoring to do this year as we look at personal lines. So the plan has not gotten so far as to the personal lines area, but that's an issue we're working on this year.

Mr. FITZGERALD. Mr. Chairman, my belief is that, in fact, as I've stated earlier, the marketplace can very effectively regulate and protect consumers on the issue of rates for commercial lines. And I also believe it can do so in personal lines.

But there needs to be, I think, a recognition on the part of everyone, citizens as well as legislators, that, in fact, taking this step, while it may seem to be walking off a cliff when it comes to the ability to protect consumers, ultimately will bring greater benefit to consumers of an extremely competitive personal lines market, as well as the ability of companies to compete very openly within States.

Now I state that not as an NAIC position, but as one that I hold as the Commissioner for the State of Michigan.

I think you may hear more about this as a part of the second panel today on the property casualty side.

Chairman BAKER. If I may, we just got an announcement. We have three votes pending. We have about 7 or 8 minutes remaining. I don't know, Mr. Bentsen, it's your option. Would you care to be recognized now?

Mr. BENTSEN. With the Chairman's indulgence.

Chairman BAKER. Absolutely. It would be my intent—oh, I'm sorry, Chairman Oxley? All right, it would be my intent to recess the subcommittee pending Mr. Bentsen's comments and we would be in recess for about 15 minutes and return as quickly as possible.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman.

I get the impression from looking at the testimony, Mr. Fisher, that the ACLI is appreciative of the speed to market initiative of the NAIC, but is concerned that it maybe doesn't go far enough in providing I guess what would be an insurance blue sky for purposes of speed to market.

Is that a correct interpretation?

Mr. FISHER. I think we are certainly more than appreciative, we're very supportive of it.

But you are correct, as I said in my testimony, in identifying the fact that it does not really meet all of the objectives that we see as the optimal system of regulation, and specifically it does have a single point of filing, but there are still individual State approvals within that single point of filing.

We are looking for a single point of filing with jurisdiction over products for all States and acting on behalf of all States. That is one big difference.

Mr. BENTSEN. And Representative Parke, in your testimony, you state the idea I believe for the concept of perhaps a State-run national organization, but very separate from the Federal Government.

I guess my question to the entire panel is, one, with the speed to market initiative, is there a legal need at some point for a Federal uniform standard to provide some legal certainty?

And second of all, what would something like a Federal blue sky, which otherwise does not impose upon State consumer regulation, and I realize that's broad assumption, would that be something that NAIC or Representative Parke, your organization would be in favor of or is that something that you think would work.

I realize that securities and insurance really are different animals in many respects. Insurance products are not necessarily as uniform as a lot of securities products. But it seems to me that that might be an answer to your problem and perhaps to Mr. Fisher's organization's problem.

Is that something that you all see as achievable, and do you think you need some Federal uniform standard at some point.

Mr. PARKE. If nobody's going to jump in, I will.

I believe that giving the NAIC the time, their commitment is there to solve that problem. We have worked well with them. They've shown an interest in making sure that the State legislators have input into developing that kind of a system.

I'm confident the NAIC and the insurance industry can work together to find an answer to that problem, and I do not believe that the Federal Government has a role in solving that problem.

Now, if we can't, then I think that you have a responsibility to the citizens of this Nation to find an answer that works, and to the insurance industry, because we need products that consumers can use in a short period of time, because the interest sensitive nature of the product or the competitive nature with other institutions is necessary, so an answer has to be found.

Mr. FISHER. I'd just like to point out it's an intriguing idea and theoretically I guess it could work. I think product regulation is a far more difficult issue to work with than say agent licensing.

And as it was, there was certainly opposition from many States to the NAREC proposal. So I'd like to be optimistic that the approach you're talking about would not encounter opposition.

I'm not quite as positive on that.

But in addition, I think if you're talking about congressional action, there may be other solutions to the problem that would have to be examined, and I think we'd want to be very sensitive to looking at the same Congress perhaps pursuing different solutions at the same time.

Mr. FITZGERALD. The greatest degree of competition that insurers face today with the other financial services marketplaces is really on the life and annuity products, not so much the property and casualty products.

And I would concur with Representative Parke's earlier statement that the use of the interstate compact is a mechanism that the State legislatures and governors can very effectively use to create the nationalized, but State-based system that take the elements of CARFRA and makes CARFRA the place to go for whatever product approval or rate form approval that might have to occur.

It is voluntary today, but the States that are a part of it, if they are going to become a part of it, basically say that we will go along with what the CARFRA decision is.

So what you propose would certainly be an intermediate step between the system that we have today and having, for example, a Federal regulatory system in place.

But again, I think that the States can demonstrate over the coming 3 to 4 years that, in fact, that step might not even be needed.

Chairman BAKER. Mr. Bentsen, we're under 3 minutes. I'm told that we will have another vote in about an hour, so the good news is, when we get back, we may be able to finish with this panel.

I'm told that Members do have additional questions. We'll return as soon as possible. Thank you.

[Recess.]

Chairman BAKER. I'm informed that we will expect another vote on the floor somewhere around 5:00. It would be my hope that we could proceed to conclude today's business before being interrupted with that vote.

I recognize Mrs. Biggert at this time for questions.

Mrs. BIGGERT. I want to direct this question to my friend and former colleague in the Illinois House, Representative Terry Parke.

Terry was and still is known by all his colleagues in the Illinois General Assembly as the insurance guru, so I'm happy that he is here to enlighten us today.

Representative Parke, do you think that the Illinois rating law, which uses a market-oriented approach provides less protection for consumers than other laws of other States?

Mr. PARKE. Congresswoman, I would say that people seem to think because we let the insurance industry go about their business that there's no oversight. Quite frankly, it's completely the opposite.

Under our market conduct examinations, we probably are more stringent than the majority of the States to make sure that solvency and marketing and all the other ways of checking the quality of an insurance company is there. And they review those insurance policies that are offered up.

So there seems to be a misconception that because we have no rating law that it's wide open and wooly. It's not. Our insurance department is known as one of the best insurance departments in the United States, and that's because we have a professional staff that reviews all those products, reviews the companies, make sure that they are operating properly and that we protect the consumers.

Mrs. BIGGERT. Well, then, if the consumers are protected under the Illinois system, wouldn't uniformity be most easily achieved if we moved towards a file-and-use, or a use-and-file system rather than a prior approval system in the marketplace for all the States?

Mr. PARKE. Well, I've served in the Illinois House 17 years, and during that time, I think the last time there was any legislation presented in the Illinois House to change what we have in Illinois may have been 10, 12 years ago.

Since then, even our most liberal and consumer-oriented legislators have come to the realization that what we have in Illinois works to protect consumers. If it wasn't, we would have all kinds of legislators introducing legislation to change what we're doing. It is not happening.

The consumer in Illinois is well protected and we believe we're doing a good job. If we're not, the legislators will come in and try and change it.

Mrs. BIGGERT. Thank you. I think that's probably true with a number of bills that are introduced each year in the Illinois legislature. If you can find something to tweak, it's done.

Thank you.

Then, Mr. Fisher, if a consumer, say in Massachusetts, wants to buy disability insurance from you that you're selling in New York, can they do that if Massachusetts' insurance department is still delaying approval of your product?

Mr. FISHER. No. It's a State-based system and I think that regulators and certainly companies would frown upon individuals crossing lines and companies participating in that type of activity.

So if a product is not approved in a given State, it really means you should not be marketing that product to the residents of that State.

Mrs. BIGGERT. So this really does affect your ability to roll out a new product if some States have approved it and some haven't, and if they are neighboring States in particular.

Mr. FISHER. It most definitely does, I can tell you, having been in the home office of Mass Mutual for 30 years. Mr. Parke and I were talking a few minutes ago. He's a former Mass Mutual agent. He was probably the guy who was calling us on the phone some years ago and we didn't have a product in Illinois.

There are tremendous pressures when we roll out a product and we can't roll it out in all States. And that's the norm, by the way. We will usually go for 35 to 45 States in our initial rollout.

The remaining States are a problem, and in some cases we do not have products in some States and have just not been able to get them approved, and you finally give up, or the requirements are so different from other States that you have to totally reprice the product, and then you have to do a basic cost/benefit analysis.

And in many cases, we have just concluded that a product is just not going to be available in a given jurisdiction.

Mrs. BIGGERT. Thank you.

Just one other question to Representative Parke.

NCOIL has not endorsed the Illinois model. Have you tried to bring that up to them, or is this something that you presented to your group, or has your organization endorsed any of such models?

Mr. PARKE. You're talking about the NCOIL? Are you saying NCOIL is not?

Mrs. BIGGERT. Yes.

Mr. PARKE. I'm sorry?

Mrs. BIGGERT. I just wanted to state, have you discussed with the other members of NCOIL, the State legislators, the Illinois model and how that could work in their State?

Mr. PARKE. Absolutely. We have done that, and it's also been discussed at the NAIC meeting. I've been at meetings where it's been brought up. Our insurance commissioner has made a point for us to go. He's also made a point to make sure that whenever I discuss the Illinois experience, that we tell them how the insurance industry is highly checked and rechecked under our market conduct programs, to make sure that they understand it.

Yes, we've talked about it and there is interest from other States. I've gotten requests for our legislation, so yes, there is, and we see that some of them are starting to move that way.

But again, I will reemphasize that GLBA has really been the shot across the bow of the States to say, hey, it is time for you to reevaluate the product lines, how fast it is to get approval on products, because the consumers need these products and you're going to have to provide the services to the companies and to the consumers.

Mrs. BIGGERT. Thank you.

Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Ms. Biggert.

I want to return to the topic one more time before we release our witnesses, make another run at it, maybe this time with the prior admonition I was a State legislator for 15 years before losing my mind and coming to Congress.

So I have great regard for State regulation and State authority, but there is a point at which we have to say, let's take a look at this.

There are bank products, swaps, fixed income annuities, others that are not called insurance products under banking law, but it's a pretty fuzzy line.

And then there's clearly securities products which are, you know, hedges that are basically insurance product in consequence, although not regulated that way.

So we have two industries under Gramm-Leach-Bliley, securities and banking, that have the ability to go to market without individual prior approval from the States that are competitive to the other component in the market.

That in itself is an imbalance which we feel some responsibility to address, because we have created the ability for the others to form these new structures.

Second, the consumer interest in this matter is the most important, and facilitating access to the best product at the lowest price would result, I believe, from this effort.

To that end, you've suggested that, don't do anything else right now. We're in good faith, we're moving fast, and only act if we don't get it done.

My difficulty with that approach is 3, 4 years from now, if we haven't got it done, then we've got to start then. It would seem appropriate to suggest this.

How about legislation, near term, next year, that says 3 years from the passage of that bill, if you haven't adopted nationally the standards in CARFRA, maybe the National Association of Registered Agents and Brokers (NARAB), some standard, if you want to just call it CARFRA as the model, then in 3 years hence that becomes the method of implementation, as opposed to some who share grave concerns about saying the words "national charter."

What's your reaction to that, so that we don't get to a point of meltdown, assuming the worst. If you're correct, triggers don't matter because you're going to achieve the uniformity that is desirable.

But let's not wait till we get to the train wreck to start talking about controlling the traffic flows.

What's your response.

Mr. FITZGERALD. I think that taking that sort of a step, similar to what was done with NARAB, for example, perhaps strikes the appropriate balance between the interests of the Congress and the ability of the States to, I believe, best execute the regulation that occurs.

It would also have the advantage, of course, of keeping in the process the State's governors and legislatures.

We are showing through CARFRA that the States can come together, so if the members felt that sort of a step was appropriate, I think that would be far superior to taking the bigger leap of creating a regulatory option of either Federal or State regulation. It would keep the best balance in place right now, and I think ultimately for the consumers of this Nation, allow them the greatest access to the regulators, those of us at the State level.

And I do have the advantage of being not just the chief regulator for Michigan for insurance, but also for banking, credit unions, consumer lending, as well as for securities. And so I'm seeing the entire spectrum.

It's an interesting challenge, but it's one that I think demonstrates where we are going in the future. And that is the markets are coming together. The regulators ultimately probably have to come together too to be able to do the best job, and ultimately there probably needs to be some partnership between the Federal and the State systems with the State systems still having the predominant role in execution of regulation.

Chairman BAKER. Does anyone want to express a concern about it?

Please?

Mr. COVINGTON. Mr. Chairman, I just might comment. I think Commissioner Fitzgerald's comments relate primarily to life insurance products. With regard to property and casualty products, I will concede that based on political pressures, in a number of States, that it will be an uphill battle to implement some of the property and casualty reforms that we're seeking.

We could probably, I don't want to get into naming names today, but you've talked about your own challenges in your home State. And I would not be fair if I did not recognize that and concede that there are going to be enormous challenges to getting that done.

And that's the only thing that I would share. I don't want to get into the details of how we accomplish that. It's hard from a philosophical approach to give up the State regulation, but I do think I need to share that with the subcommittee, that there are a number of large States, significant States where consumers, I think, are being hurt because they don't have a good market because of over regulation today.

And we're seeing that. And we've seen pullouts in States. We've seen good Ohio companies, we have a lot of good property and casualty companies who will not go into certain States because of rate oppression and in the end, that hurts consumers.

Chairman BAKER. Thank you, sir.

Mr. PARKE. Mr. Chairman, as I said earlier, I've been in the legislature 17 years and I sometimes try to read between the lines. And it's been my impression that Congress may have had the will to do more with GLBA than they probably would have.

I think that the intent, as an outside observer not knowing the facts, but the intent was that this is the opening volley. This is something that must be complied with. The intent is to be understood and you mean it, and to not let it work, I think, is not the intent of the legislation.

Many times my colleagues will say, let's not move any further until we see if it's working. We have shown in the States that we are working, we are achieving the goals that you established.

Certainly that's why you are having a hearing here today is to try to say, we expect more, not just the minimums. And we hear that.

Chairman BAKER. I was really playing back your words that, if we can't get it done, then maybe it's appropriate for Congress to act.

I'm trying to find a middle ground here, if we set some time line. If it's not 3 years, then maybe it's 5 years. But some limit which reasonable people can agree, well, if we can't get it done by then on these sets of standards, then maybe it is appropriate for the Congress to act in some additional manner.

And if it's not CARFRA in 3 years, I'm just asking this, you know, maybe you don't have to give me the specifics today, but think about it. What would that box look like.

I will confess I was involved, to some small extent, in Gramm-Leach-Bliley and you'll be shocked to learn there was a considerable bit of political discussion ongoing in that room, and sometimes that tends to limit what the sausage will look like when it's finished.

So I can assure you from my perspective there were those who were a great deal more enthusiastic about going a lot further than just getting us up to 1990. Some of us actually would have liked to have gotten the law up to about 2001, but we're going to work on that.

In order to facilitate this and not have the hanging contingent of people in your capacity feeling like the Congress is going to act recklessly, and without regard for your responsibility, we, on the other hand, want to feel like we're getting it done at a level sufficient to make markets work, and some agreement between those two positions to establish CARFRA, NARAB, you pick' em, in some timeframe appears to me not to be that irresponsible, rather than wait and find out well, we just didn't get it done. Now we're going to start looking at it.

And that's really the purpose of these hearings. How do we move forward with the assurance at some point reasonably in the future, we establish a market principle that makes sense for everybody. And that doesn't require a response. I just want to communicate that in the best way I can.

Yes, sir, Mr. Fisher, did you want to comment?

Mr. FISHER. Mr. Chairman, I guess I would have to express a slightly different viewpoint from that of my fellow panelists.

One potential concern we have, aside from any constitutional issues that might be lurking out there on that type of proposal, is that if, in fact, things could not get done, then an awful lot of time has been lost in the process.

And we have grave concerns about that. You heard about the loss of sales that my company alone is experiencing. If you multiply that by the number of insurance companies doing business, and I'm just talking life insurance, it greatly ups the ante.

The ACLI, as you know, is looking at different options and pursuing different options currently, although a final decision has not been made on one of them, for improving regulation of insurance, life insurance.

Assuming that a decision is made to pursue the other option, other than the State's option, we believe that it might be appropriate to pursue both options concurrently.

If the States are capable of proving that they can achieve the efficiencies, then it may well be that Congress would want to look and maybe we should discontinue the pursuit of the other option.

But we do have concerns about the time involved.

Chairman BAKER. Well my point for initiating the question was, we don't want not to be cooperative in allowing the commissioners, the legislators, and the States to engage in what they believe to be responsible for their consumers. But at some point, we have to establish we can't wait any longer.

And I'm merely trying to get a date by which reasonable people can agree we can't go past this. And at that point, we would then have a requirement, that we could also agree would be reasonable, that makes whatever the next modest step that's agreed to automatically implemented.

The concern we have is that we don't take any near term action, that we find ourselves 3 years hence with still partial implementations and disparities, particularly in property and casualty, and that there is indeed great pressure to act very quickly as opposed to a more studied approach that is more responsive to the States.

And that's my point, and I appreciate your testimony.

Mr. Sherman, I believe you're next for recognition.

Mr. SHERMAN. I would think that prompt approval of new insurance products could have a couple of advantages to the consumer. Either you're in a State where there's a particular type of insurance that might fit your needs and it's not available, or several companies that could offer that type are not allowed into your State, and you're stuck choosing from only one or two companies without perhaps the requisite level of competition.

I come from a big State, California. I've been dazzled and occasionally confused when presented the entire smorgasbord of available insurance products. And I'm surprised to be here at a hearing that seems based on the idea that there might be more insurance products that my constituents need to buy that somehow they're not being offered.

Can one or two of the panelists identify a type of product that isn't available in a major State or a contour of that product that isn't available in California or some other major State, that you could explain to me, that my constituents would be better off buying if only they could?

Mr. COVINGTON. Mr. Sherman, I do have an example of a product. A good company in our State of Ohio, Nationwide Life Insurance Company, introduced or tried to introduce a product a few years ago, a long-term care product, coupled with an annuity, so that you had both a savings component and a protection component for the central long-term care needs.

And I know your State probably has a lot of seniors, a large senior population.

Mr. SHERMAN. And an awful lot of interest in long-term long-term care insurance, although I guess you could buy these separately, I don't know if there's a shortage of annuity policies, for example.

Mr. COVINGTON. This product was a unique product that served a particular marketplace. We know today that the company was not able to get that product approved in six of the largest 12 States. That's not good for consumers, it's not good for the company that's trying to compete with other financial services.

Mr. SHERMAN. I mean, I can go to a store and buy toothpaste, I can go to a store and buy socks, I've never seen an opportunity to buy the two packages together. I never needed that opportunity. I just buy them separately.

Is there anything about this product that's any different than simply purchasing separately at a competitive price, a retirement home coverage policy on the one hand, and an annuity on the other. Other than the fact that the two are packaged together, was there anything special about this policy?

Mr. COVINGTON. There were differences. I'm certainly not a product expert, but as the product was explained to us, we thought it was innovative, we thought it treated a particular market in our State. We approved the product very quickly in Ohio, and we think it benefited consumers.

Mr. SHERMAN. Why in those other States did they face a hang up except for the fact that nobody had seen that particular combination?

Mr. COVINGTON. That's a great question and I don't have an answer for you.

Mr. FISHER. I can help to answer that question, Congressman. First of all, with respect to the question about whether it is better to have and can't you do it through two products rather than through one. I'm not an actuary, but it is important to understand that there are some basic loads or fees associated with the product just to cover the cost of issuance and administration, so you lose out.

It's cheaper to have something combined in one product than two.

Mr. SHERMAN. But, I mean, we could always posit the idea that maybe there's somebody who needs boat insurance and, you know, coverage for their stamp collection from theft. And I'm sure that you can't buy those two policies together.

What I'm saying in effect is I'm looking for a product that isn't available in major States, not just a unique combination of two products that can probably be purchased separately. Otherwise, there would be a dazzling array of combos that aren't available.

Mr. FISHER. Not necessarily. One product would certainly be cheaper. When you're talking about the long-term care arena combining some of these products, that is a newer type of long-term care product on the street. It is a very efficient product.

Going partly to your question about what about the other States, why, I can speak to one of those States. There's a law on the books that was literally over 100 years old and said you can't combine two lines into one. That was it. That was the sole reason for that jurisdiction's proper refusal to approve the product. They did not have the regulatory authority.

That law was changed, by the way.

Mr. PARKE. Congressman, I might flip this around another way, in looking at it and say that some products should not be approved and speed to market is not the ultimate goal. Protecting the consumer from the product that is marketed to be there when the consumer needs that product is another.

I want my insurance departments to be deliberative and make sure that they take time to review and make sure that policy——

Mr. SHERMAN. I understand that argument. Kind of the underlying hearing here is that we're going to have, as I understand it, the possibility of two avenues to get a product approved. And if you feel that we've got to make sure that bad products aren't approved, if anything, we should stick with the present system.

If the goal is to make sure that good products are approved and approved quickly, then we might need to change the law.

What I'm trying to explore with my questions here is, is the present system of saying the only way to sell a product to a Californian is to go through the California Insurance Commissioner's office who may, for a variety of reasons, not let you sell that product.

Is that a problem, or is this a solution in search of a problem?

Chairman BAKER. Mr. Chairman, if I might, I'm sorry, you've exhausted your time by a small measure.

And just a line response, if I might. I'll use my own State as an example. On average it takes in excess of 300 days a year to get any new product approved.

We have significant withdrawal from our market in large measure and I have a statement from my current acting commissioner, our former commissioner has other difficulties——

[Laughter.]

Chairman BAKER. ——Indicating that it would be of great help to have form uniformity to expedite delivery of appropriate products to consumers. And the purpose of the hearing is not really to establish a national charter issue, which is underlying the statement I think the gentleman was asking.

Mr. SHERMAN. If it wasn't a national charter, is the focus of this hearing some sort of Federal system to approve products more quickly.

Chairman BAKER. No, really it was to have the commissioners report on the progress with the voluntary initiative known as CARFRA, which involves ten States on limited product line, and also to have others comment on whether or not they viewed a problem in the market.

And all these four gentlemen have indicated they perceive there is a problem that might be difficult to resolve with State initiatives. They are optimistic they can do so, but they understand the Congress' interest and intent to see it resolved in a timely basis.

Mr. SHERMAN. So our focus here is to see whether the States in combination are doing a good job, with the possibility of some Federal role?

Chairman BAKER. I'm the last person to explore or suggest that another Federal regulator is a good thing in Washington, but I will say that despite the best efforts of the States, if we can't have uniformity and approval forms marketing, there is a consequence to consumers as a result of that, and this hearing is to have their report, make assessments as to that progress, and at some later time determine if additional action by the Congress may be warranted.

Mr. SHERMAN. I commend the Chairman for holding these hearings and I yield back the entire balance of my time.

[Laughter.]

Chairman BAKER. Thank you very much, and as usual, we're always on the same page.

Ms. Hart, did you have a question?

Ms. HART. I do, Mr. Chairman, but I'll be brief.

First I want to thank the panelists for being here. I served in the State legislature for 10 years and I served on the banking and insurance committee in Pennsylvania, so I dealt with a lot of these issues, and one of the things that I think is most interesting is that, without the Federal Government taking over control of insurance regulation, we can somehow assist the States in coming to some common ground. And that's what I believe we're looking for here.

I have a couple of people from different States before me. My question is how far should we go when it comes to us playing a role, and I know some of you may have answered some of these questions because I wasn't here the whole time, but if you would just humor me.

I'm interested in knowing right now, I know you go through your associations, the NAIC and I guess some of the professional associations as well to try to make everybody as uniform as possible.

But when it comes to our role, do you see us being involved in some kind of way, and what would that be?

Is it oversight?

Is it just shaking your hand and being friendly?

Is it beyond that?

Mr. FITZGERALD. Friendliness is always good. I think the role that this subcommittee and this Committee is playing in oversight is a very appropriate one. The commissioners know legislatures clearly are learning that the Congress does take a great interest in the insurance system of this country.

I think that a continuation of this oversight and an indication of the interest is going to keep the pressure on certainly for us to continue bringing about the reforms that are necessary.

I would hope that ultimately that is the only role that the Congress would have to play, that the States can prove themselves capable of bringing about the reforms that will move us over the coming years and put the insurance industry in the position it needs to be viz a viz the other financial service industries, to allow them to compete effectively and allow the consumers in this Nation to have the quality products and the appropriate degree of oversight and regulation that is necessary to best protect them.

So my ultimate hope is that this sort of hearing on an on-going basis would be the role that the Congress can best serve.

Mr. PARKE. I might also point out that GLBA has given us the guidelines with time triggers, saying you must achieve these goals.

The States are working toward that and we are achieving those goals. So I think that you have played a role of establishing in the minds of all people in the insurance arena that Congress is going to watch.

You've already established those guidelines. Now let us work toward solving those guidelines. And if you see that we're not hitting the triggers, then I think you do have a responsibility to come back and revisit some form of GLBA with new triggers and maybe those triggers would be appropriate in other areas than you've already dealt with.

Mr. FISHER. I certainly agree with Representative Parke, but GLBA really addresses an agent licensing issue, but only in part. I don't think it's addressing the speed to market issue from the ACLI's standpoint. As I mentioned, we are pursuing a track right now, assuming there is an ultimate decision to pursue the track other than the State track.

I think we would be looking to Congress to carefully evaluate that option. It's not a question of taking regulation away from States, it's a question of setting up a system that is comparable to that which the banks enjoy.

Ms. HART. Right now, if you had to assess cooperation among the States, would you say that since Gramm-Leach-Bliley, cooperation has improved and that the insurance regulators are working together more, or do you think that it really hasn't changed from before that?

As a constituent service person, I spend a lot of time, unfortunately, trying to contact other States trying to get somebody a license to help somehow get a product that might have been coming out of a Pennsylvania company into another State.

We have all kinds of problems, and there seems to me to be just really no consideration for another State among some of the States' insurance regulators.

Has that changed?

Mr. FISHER. I think it's fair to say that through the NAIC especially, the State regulators have always worked with one another. I think Gramm-Leach-Bliley and the changing marketplace have really heightened that concern, especially because I think regulators have a better understanding of the regulated industry's concerns.

However, the other side of that is that nobody should underestimate the daunting challenge ahead of the State-based systems in terms of achieving uniformity for speed to market, because you are talking about major changes to a wide array of laws in a large number of States, and you're really going right up against the question of State sovereignty.

Chairman BAKER. Thank you, Ms. Hart. Your time has expired.

Ms. Jones.

Ms. JONES. Thank you, Mr. Chairman, for holding this hearing.

I would like to particularly welcome Mr. Covington from Ohio—I'm from Ohio, just in case you didn't know that, Mr. Covington—to our hearing.

Previously, our subcommittee did not have the responsibility for insurance. There was probably not much reason for us to get to know each other, but now that there is, it'll be fun to get to know you. I look forward to having the opportunity to work with your staff and mine, as we walk down this road.

I left my glasses on my desk.

You're Mr. Fisher to the far right? Is that correct? Is that you?

Mr. FISHER. Yes.

Ms. JONES. My question, Mr. Fisher, when I first came to banking, which was last term, and we were discussing handling HR 10, the opinion I got from everywhere around the world was that the insurance industry did not want to be regulated, please leave us alone, and so forth, and so forth, and so forth.

Was it that I didn't get the right signal by this new legislation, let me just put it like that.

Mr. FISHER. Are you talking about the regulators or the industry?

Ms. JONES. Regulators.

Mr. FISHER. You might want to address that question to the regulators.

Ms. JONES. I know what they think. I'm asking you, Mr. Fisher.

[Laughter.]

Ms. JONES. Have I put you on the spot?

Mr. FISHER. This seat is getting a tad hotter than it was a minute ago.

I think it is fair to say, on a more serious note, Gramm-Leach-Bliley was really addressing the question of functional regulation and who should regulate what.

That is getting into the question of, to some extent, turf, to use the term bluntly.

I think that there certainly was some opposition to it, and Gramm-Leach-Bliley ultimately passed.

What we're talking about today is really not a question of functional regulation and who should regulate what, but what efficiencies should be built into the system of insurance regulation.

Ms. JONES. That was a great answer, but it didn't answer my question. My question is what was your personal position with regard to whether or not there should be some Federal regulation greater than currently exists on the industry, the insurance industry?

Mr. FISHER. Again, I think the Gramm-Leach-Bliley was not getting into the question of whether there should be Federal regulation.

Ms. JONES. Again, you know, I got accused of being one of these terrible examiners, because I made people answer my question. Answer my question, please.

What's your opinion, it's either a yes or a no, or something.

Mr. FISHER. Of whether?

Ms. JONES. Of whether or not there should be greater regulation by the Federal Government on insurance in the States, and it should be removed from State insurance regulators?

Mr. FISHER. Assuming that the ACLI pursues the two tracks that it is currently pursuing, the ACLI would not favor elimination of State regulation. There are many ACLI member companies who would want to continue to be regulated by the States.

However, companies which might have an interest in an optional Federal charter, assuming that decision is made, I think the ACLI would want to pursue that track.

Ms. JONES. Mr. Covington, do you want to tackle that for me? A similar question. If this is a hot question. We'll go on to the next question.

Mr. COVINGTON. If you could restate the question?

Ms. JONES. During the course of the debate over Gramm-Leach-Bliley, or HR 10, which is a lot easier to say, there was the whole discussion that the State insurance industry or regulators or the like were not interested in being included in some revamping of your responsibility, that much of the regulation should be left to the State insurance agencies as it currently existed.

What's your position?

Mr. COVINGTON. What I can speak to is what the State regulators' position was, and that was that we supported functional regulation at the State level.

I can't speak to the industry's position.

Ms. JONES. I guess I have to wait till I get me an industry panel then.

Can you answer this about whether the insurance industry finds itself at a disadvantage as compared to the foreign insurance industry with regard to the delay in product approval?

Mr. FISHER. I don't think that's really an issue, because if the foreign insurance industry is doing business in this country, it is subject to State regulations, so it would be subject to the same issues. The competitive disadvantage, there is some within the industry, is because if I can't get my products to market, I may be behind one of my insurance competitors.

However, a large amount of the competitive disadvantage is viz a viz other financial services sectors, such as banks and mutual funds, who can get their products to market more quickly.

Ms. JONES. And I'm out of time, darn it. I guess I'll just have to yield.

I was getting ready to get to you, Mr. Fitzgerald. Maybe on another occasion.

Chairman BAKER. Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman, and I will be brief. I happened to have a meeting with some of the industry on this question just this past week.

Also, there was a meeting that we had, a report that came by from the Consumer Federation of America and unfortunately I didn't get the chance to hear the testimony, so I don't know whether or not you addressed this or not.

But they seemed to have some concerns recently that in an effort to satisfy our concerns with delays for new products and rates, that the State commissioners will make some recommendations that will roll back some of the consumer protections that had been won on the State level.

So I guess I was wondering, especially with reference to—and I guess I'll address this to Mr. Covington—the NAIC's speed to market working group. What did you put in, or was there anything put in there to appropriately protect consumers from the reforms that are being proposed?

Mr. COVINGTON. Congressman, we just received in the last week-and-a-half, the Report from the Consumer Federation of America, and have not had an opportunity to review it in full.

We will be having meetings where that report will be presented to the National Association of Insurance Commissioners and considered by us during the process.

As we testified, for commercial lines insurance, the plan calls for an informational filing or a competitive rating system.

We believe that this protects consumers better because you don't have artificial price suppression which impacts the availability and choice for consumers in the marketplace, and that exacerbates some problems in the marketplace.

With regard to personal lines insurance, we have just begun the process of evaluating the best regulatory system for personal lines, and we've had one medium where we've had 18 panelists testify before the subcommittee, and we will continue that work throughout the year.

Mr. MEEKS. Let me just make sure that I understand, because I understand that in the industry right now, there is a lot of artificial pricing where a number of insurance groups have given so-called discounted prices, knowing that in just 3, 4 years, the price is so cheap that ultimately they're going to have to charge a much higher premium 3, 4 years down the line, and therefore putting the companies, some of these same companies, in financial difficulty.

And again, I'm just trying to see if there's anything specifically being put in place right now, as we're working on this reform, that specifically says or specifically talks about how we're going to take care of the consumers to make sure their protection's in place.

Mr. COVINGTON. Well, let me just comment, Congressman, with regard to the financial solvency of the companies.

The NAIC has instituted a financial accreditation program, and in that program, there's a financial analysis. And one of the things that will be looked at is the adequacy of rates to support the business. So there is adequate consumer protection from a financial solvency perspective.

In addition to that, most State laws already say that rates cannot be excessive, unfairly discriminatory or inadequate, so that is a protection in and of itself as well.

So there are adequate protections in the consumer plan that was adopted by the National Association of Insurance Commissioners.

In addition, the plan calls for greater consumer information so that they can price shop more effectively, which we think we should encourage all consumers to do. There is enormous competition in this marketplace, and consumers should shop better.

We can assist them in that effort by providing better price information.

Mr. MEEKS. Mr. Fitzgerald, what about CARFRA?

Mr. FITZGERALD. I think the most significant point is that, as we have worked on the speed to market program over the last 15 months, both for CARFRA which is directed right now more toward life, as well as the improvements to State-based systems, we are not removing any consumer protections.

In fact, doing things that have not been done before. For example, the review panels for CARFRA. We have established standards for those examiners who will serve on those panels to make sure that they are experienced, have the appropriate training, as well as experience, to provide the highest quality review.

Those are the sorts of things that we are doing to ensure that into the future, we will have the consumers of this country protected when it comes to insurance products.

But at the same time, we have to look for steps where we can speed the process so that products, quality products, can become available more quickly.

And from an industry standpoint, on a similar standard to what's happening with banking and securities products, so everybody can ultimately benefit.

Mr. FISHER. Congressman, if I could also just respond from a life insurance viewpoint. Rate regulation is not an issue that pertains to the life market. It's really a property and casualty issue. If that is a concern for anybody, it's not one that applies to the life side of the house.

As Commissioner Fitzgerald suggested, we are not talking about elimination of consumer protections, we are just talking about more uniform but strict product requirements.

Chairman BAKER. Thank you, Mr. Meeks, your time has expired.

I'd like to express appreciation to this panel for your participation. Members will reserve the right to formally submit questions that they may advance to you at a later time.

We do appreciate your courtesy in appearing here today. Thank you very much.

I'll call our second panel up.

Let me make this advisory. We really need to try to get our testimony concluded and potential questions asked somewhere around 5:00 o'clock, because I'm told we could have the final vote of the day on the floor somewhere around 5:00.

So as you're getting settled, there is a potential to summarize your statements as you proceed on this next panel.

Since we have five different individuals presenting testimony, it will be difficult unless we expedite statements as much as practicable.

[Pause.]

Chairman BAKER. I'd like to introduce our first witness in the hearing this afternoon, Mr. Robert Gowdy, President, OneBeacon Insurance Group, Chairman, American Insurance Association, (AIA), on behalf here today of the AIA.

Welcome, Mr. Gowdy.

STATEMENT OF ROBERT C. GOWDY, PRESIDENT, ONEBEACON INSURANCE GROUP; CHAIRMAN, AMERICAN INSURANCE ASSOCIATION, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION.

Mr. GOWDY. Thank you, Chairman Baker. My company writes both personal and commercial and property and casualty insurance——

Chairman BAKER. And pull that mike really close. They're not very sensitive, sir.

Mr. GOWDY. Thank you.

We write property and casualty insurance throughout most of the United States so we certainly know firsthand the challenges of operating with 50 different regulators.

Today, I am appearing on behalf of the American Insurance Association, which represents over 370 major property casualty insurers. And on behalf of that entire membership, I'd like to thank you for the opportunity to testify before this panel.

Speed to market or the ability to bring products to market in a timely and cost-effective manner is a fundamental and longstanding concern of the AIA and its entire membership.

I will focus my verbal comments today on three things: the costs imposed by our current regulatory system, the challenges in today's operating environment that necessitate speed to market reform, and the benefits that such reform would provide.

Over the past two decades, most sectors of the financial services industry have undergone regulatory reform to facilitate speed to market for the introduction of innovative products that have certainly reshaped our financial landscape.

I think customers have benefited greatly through lower prices, and certainly expanded product and service options. Against that backdrop of increasing reliance on marketplace and competition dynamics in the other financial services, the property casualty insurance industry stands out as an exception.

We remain one of the most heavily regulated industries with respect to both price and product controls. Each of the 50 States, the District of Columbia, and the various U.S. territories impose their own substantive and procedural filings, review procedures, approval requirements.

The costs imposed by our archaic State regulations are systemic. A major problem is a process known as form regulation, which you talked about before. Simply put, excessive form regulation prevents insurers from developing innovative new products to serve their customers better.

Each State has its own set of rules, procedures, interpretation, idiosyncracies, regarding whether a new insurance form or policy passes muster. Identical issues are treated differently from State to State.

As an example, my own company launched a new combined auto and homeowners insurance product for customers aged 49 and over called "Prime Time." Based on the results that we had had in Canada and our own internal studies, we wanted to provide a premium reduction and extra coverage. It was a clear winner for consumers.

We started the filing process in 1998 and despite our best efforts, 3 years later, we still don't have approval in five popular States. This is just one example of the excessive form regulation that creates enormous difficulties bringing quality products to the market and allowing local insurers to receive the benefits and the economies of a national operation, and even more difficult, to serve a commercial customer operating in multiple States.

In addition to discouraging innovation, the extensive delays in new product approval are tantamount to a hidden tax. According to Professor Richard Butler of Brigham Young University, the loss of consumer welfare due to lengthy delays in product approval and launch amounts to an average countrywide hidden tax for new products of about 9 percent.

This implicit tax is borne by both commercial and personal lines customers.

Rate regulation, or more specifically I should say, price controls, impede an insurance company's ability to adjust prices up or down. The result, consumers are hurt in several ways and here are a few.

First, States that have stringent price controls have long had the most expensive auto insurance costs in the Nation. In contrast, as you heard earlier, jurisdictions that have adopted a market-based approach have given consumers the lowest auto insurance prices.

Second, lower risk policyholders, for example, safe drivers, are forced to subsidize those who present a greater risk. By encouraging riskier activities, such subsidies drive up total system costs and may result in unfair redistribution of income.

Chairman BAKER. Can you give me a summary, because we've exhausted our 5 minutes, if you can.

Mr. GOWDY. OK. In the States that have addressed the issue of rate regulation, consumers, I think, benefit. Illinois is the one State that does not have property casualty insurance price controls of any kind and consumers clearly benefit.

Because of population, traffic density, the presence of a large metropolis, and other factors affecting losses, Illinois normally would be expected to rank among the top ten States for auto insurance costs. However, Illinois is right in the middle, runs 24th, 25th, or 26th, among States for auto insurance prices, and I think competition has been the key factor.

There are significantly more auto insurance companies competing in Illinois than in similar urbanized States such as New Jersey or Massachusetts that have strict price controls.

One more example, if I have the time?

Chairman BAKER. Very quickly, please.

Mr. GOWDY. That's right here in the District of Columbia, which historically has been I think identified with heavy regulation, bureaucracy, and high insurance costs. It is another real world example of how speed to market reform can dramatically improve and rejuvenate a sluggish insurance market.

Since the District eliminated price controls, rates have declined. DC. Director of Insurance Larry Morella, has said publicly that many people have been pleasantly surprised at the number of companies, even small companies who now are willing to enter and sell policies in DC., which is a relatively small market, as a result of the change in regulation here.

In closing let me just quickly revisit the benefits, based on what's happened in Illinois, DC., and Michigan is another example, savings in insurance costs, more product options and insurance markets that are better equipped to keep up with fast-paced change in our economy, new competitors entering or re-entering the market, and a reduction in the subsidies that lower risk consumers often have to provide to those of higher risk characteristics.

In closing, I would like to thank the subcommittee and specifically you, Chairman Baker, for holding these hearings. Thank you again for the opportunity to speak today on an issue I think is of critical importance for our industry, and how we compete against the other financial services industries.

Thank you.

[The prepared statement of Robert C. Gowdy can be found on page 114 in the appendix.]

Chairman BAKER. Thank you.

I'm going to restate that everyone's full statement will be made part of the record, and in the time you have, try to summarize, because I think the questions from the Members will be particularly helpful to your various interests.

Our next participant is Mr. Robert L. Zeman, Vice President, Assistant General Counsel, National Association of Independent Insurers, and on behalf of the National Association of Independent Insurers and the Alliance of American Insurers, and you are accompanied today by Ms. Rita Nowak, Assistant Vice President, Alliance of American Insurers.

Welcome, Mr. Zeman.

STATEMENT OF ROBERT L. ZEMAN, VICE PRESIDENT AND ASSISTANT GENERAL COUNSEL, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, ON BEHALF OF THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS AND THE ALLIANCE OF AMERICAN INSURERS, ACCOMPANIED BY MS. RITA NOWAK, ASSISTANT VICE PRESIDENT, ALLIANCE OF AMERICAN INSURERS

Mr. ZEMAN. Thank you, Mr. Chairman, and subcommittee Members as well. We appreciate the opportunity to testify on this important issue. Together, our organizations represent over one thousand property casualty insurance companies.

Support for the ability of insurers to compete in the marketplace has been the hallmark of our organizations from their inception.

We are hearing now though, from our members, unprecedented levels of concern regarding the regulation of rates and forms in many States and how that is hurting competition. And you've heard many examples today. We won't belabor that.

As you've also heard, there is significant diversity across the States on how property and casualty rates and forms are regulated.

Many States have grossly outdated laws that impede competition, and those include the prior approval laws. In our written statement, we cover the spectrum of rate regulatory laws, and we won't belabor the details there.

But there are States that take more competitive approaches and our members, in an array of academic studies, have found that the more competitive approaches have real value for consumers as well as industry and regulators.

Both of our organizations have conducted surveys of our members on a State-by-State basis regarding speed to market, that is, the filing of rates and forms and how they are treated.

And we received some very positive feedback regarding some States with good examples including lesser forms to complete and a clear process.

But we did find in other States, members' comments that they found impediments to approvals in the rate and/or form filing process.

Examples of the barriers to speed to market are listed in our written statement as well.

I'll just point to two key ones.

Number one, they were concerned about slow review, even acknowledgement of filings in a number of States, and unwritten standards or desk drawer rules, which have already been referred to in this proceeding.

Now some of these hurdles can be at least partly ameliorated by implementing operational reforms at the insurance department level, things that can be done right now without statutory or regulatory changes.

However, in other States, there is a need for a public policy change, a change in the law away from the prior approval system toward a more competitive perhaps file and use system.

Now in constructive fashion, we are following up with each and every State to discuss the results of the survey with each State regulator, and having very valuable discussions.

What we have found is many States are indeed moving and implementing some of these reforms. Now we mentioned that we have found, our members have found great value in competition across the States.

Our statement covers, and I won't begin to belabor here, but I want to emphasize there is a growing and very current and new body of academic evidence that confirms the value of the more competitive systems across the States and the benefits that they can have for consumers.

For example, through less subsidization, greater availability of products. Those are clear benefits for consumers in the more competitive environments.

And Illinois has been discussed already today, but we want to make it clear, a number of other States, including Wisconsin, South Carolina, and others, have taken more competitive approaches so it has been shown that the States can rise to the task.

Now our organizations support a model approach which also we won't belabor here, but it's balanced with consumer safeguards.

Yes, it brings the benefit of competition in the marketplace, but balanced with consumer safeguards including making provisions to assure that consumers have adequate information.

Part two of the solution, in addition to the public policy or law changes, involves changes at the insurance department levels, making them more efficient.

Now there are early signs in the State legislatures over the past few years and even during this round of State legislative sessions. A number of States did at least look at this issue, and we worked of course as well with a number of the State legislative groups, including NCOIL, who is here today.

But the American Legislative Exchange Council has already produced a model law on this subject. We hope NCOIL will do the same for personal lines as it has done for commercial lines.

Of course, the National Conference of State Legislatures, along with the NAIC have looked at this issue. And I've shortened my testimony obviously. But the NAIC has been the leader in driving the operational efficiency reforms at the State level.

But again, in summing up, we need reform on two fronts; changes in laws in the States where needed, and changes in the operational efficiencies where needed.

Now we do see some signs of progress out there in the States through the activities at the NAIC, adoptions by the individual States of the recommendations of NAIC, studies by the State legislative groups that I mentioned, and action in a limited number of State legislatures thus far.

Clearly, however, there is a need for more reform in the States, no question about it and the time has come for truly unprecedented and more meaningful cooperative dialogue among State regulators and legislatures, and us in the industry, consumer representatives and other interested parties. We pledge our assistance in doing all we can to help reach the goal of modernization including better speed to market all consistent with the vision of Gramm-Leach-Bliley.

I went a little over time. Thank you very much.

[The prepared joint statement of Robert L. Zeman and Ms. Rita Nowak can be found on page 125 in the appendix.]

Chairman BAKER. Thank you, Mr. Zeman.

Our next witness is Mr. James A. Blum, CPCU, Chairman and President, Brotherhood Mutual Insurance Company, Chairman, National Association of Mutual Insurance Companies, on behalf of the National Association of Mutual Insurance Companies.

Welcome, sir.

STATEMENT OF JAMES A. BLUM, CPCU, CHAIRMAN AND PRESIDENT, BROTHERHOOD MUTUAL INSURANCE COMPANY; CHAIRMAN, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Mr. BLUM. Thank you, Mr. Chairman and subcommittee Members. My company writes in 30 different States, but I'm here today particularly in my capacity as Chairman of the National Association of Mutual Insurance Companies—or NAMIC—today.

Companies doing business across the country or in a single State need to be able to enter a new market or establish prices with a minimum of difficulty.

The NAMIC Board has adopted a pro-competition model for commercial and personal lines of insurance similar to the regulatory framework used in Illinois.

NAMIC believes a pro-competition model is the most effective public policy to achieve speed to market.

Illinois discontinued prior approval requirements 30 years ago, as was mentioned earlier today, for rates, and consistently their rates are below other States with similar demographics.

There is more competition among homeowners and automobile insurers in Illinois than in any other State. After the South Carolina legislature modernized auto insurance ratemaking practices in 1997, South Carolinians benefited from the choices provided by almost twice as many insurers.

To refute what I have said in favor of competition, some will refer you to what has been written about California's celebrated passage in 1988 of Proposition 103.

Auto insurance rates have fallen and complaint volume at the California Department of Insurance is low. However, it was a series of explicit public policy choices to limit the cost of insuring drivers, not the institution of prior approval, that has caused prices to go down in California.

Then there is New Jersey. New Jersey of course was spoken of today as well. Prior approval is one of many regulatory obstacles that drive up costs in the State, and six of the ten largest auto insurers do not do business in New Jersey.

And we heard about State Farm and AIG today.

Obviously, there will be even less incentive to lower rates among those companies left in the New Jersey market.

Holding the NAIC solely accountable for enacting insurance regulatory reforms is not a realistic expectation. Individual regulators clearly have a role to play in their States to raise the profile of and enlist support of these important market reform issues.

Given the non-binding nature of the NAIC, I would submit that the more powerful players in any struggle for State regulatory modernization are the State legislators.

Working closely with State legislative organizations like NCOIL, the NAIC has been able to coordinate enactment of the necessary legislation for accreditation in nearly every State across the country in the 1990's.

This example underscores the type of action that we all seek to achieve for speed to market reform.

Property casualty markets are structurally competitive. There is no apparent benefit to companies or consumers in a system where rates must be approved prior to their implementation.

NAMIC supports model legislation to be adopted by each State to establish competition as a matter of State law, relieving all commercial writers from prior approval requirements and allowing personal lines writers to set the price of their product without government approval.

One academic study has concluded that in States with the strictest regulatory approval process, entry to the market can take almost 90 percent longer than it does in States with fewer approval requirements.

There are also widespread industry complaints about the use of so-called desk drawer or non-statutory regulatory requirements. In other words, regulatory decisions are being based on rules with no basis in law.

These hearings are helpful to the reform process and we welcome them. They keep all parties engaged in the discussion of how competition can be enhanced in all segments of the financial services industry.

No insurance company and no State will be unaffected by the outcome of this debate.

The NAIC did well to develop its statement of intent in March 2000, focusing its attention on the most pressing market reform issue, speed to market.

But this is a preliminary, critical step of an important, but nonetheless voluntary organization. Ultimately, the accountability for reforming insurance regulation is with State legislatures. We believe they are up to the task.

Thank you for this opportunity to appear today, and I tried to stick closely to the text.

[The prepared statement of James A. Blum can be found on page 142 in the appendix.]

Chairman BAKER. Thank you very much, Mr. Blum, we certainly appreciate your testimony here today.

Our next witness is Mr. J. Robert Hunter, Director of Insurance, Consumer Federation of America.

Welcome, Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER, DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

Mr. HUNTER. Thank you, Mr. Chairman.

I am Bob Hunter, Director of Insurance for the Consumer Federation of America, and I served as Federal Insurance Administrator under Presidents Ford and Carter, and as Texas Insurance Commissioner.

First, I would like to tell Congress that these hearings and other activities by Congress have been used by the insurance companies to try to push the States and NAIC into submission to cut away vital consumer protections, not just to get rid of the fat, but to go beyond that, to cut into protections what we need.

I just have a few comments. I'll try to stay within 5 minutes.

Consumers do not want speed to market for bad products. There is no evidence that consumers are clamoring for insurance products, nor any evidence that there are products that are not available.

There's certainly no pressure for speed to market coming from the victims of life insurance company vanishing premium abuses or churning abuses, or race-based premiums.

Deregulation does not assure more competition or beneficial competition. For instance, deregulated policy forms can make price competition impossible. That's why Illinois regulates policy forms.

Competition is not always beneficial for consumers. Some forms of competition are absolutely harmful to consumers. For example, competition that leads to insolvency. Nobody proposes getting rid of that regulation.

Reverse competition in credit insurance, where competition is for the bank or car dealer and the competition drives up rates to allow bigger kickback commissions. Fine print competition where insurers would hollow out the coverage with clever policy language to offer low rates, but with no coverage, and selection competition, such as redlining in our cities.

These are competitions that should not be allowed. Just enacting deregulation without making competition effective will not produce good results. Prior approval rate and form regulation intelligently coupled with the repeal to many of the State anticompetitive laws, such as antitrust laws not imposed, works best.

Consumers do not care if the Federal Government or the States regulate insurance. We only care that the protections be acceptable and excellent.

Consumers do not favor a system where the regulator gets to choose who regulates them. This is a sure prescription for a race to the bottom in insurance regulation.

Consumers support many of the changes that the NAIC has underway. We identified many of the ways States could shorten the regulatory process. We supported a 30-day limit on final action. We supported getting rid of the desk drawer rules.

What we don't support is mindless deregulation, which we say is just stopping regulation to make competition happen. That is not the way to make competition happen. States have not fared well in controlling unfair and deceptive policies and practices. MetLife, John Hancock, Prudential, all those abuses were raised first in private litigation.

We fear that mindless deregulation, as proposed by the insurers, will result in a bonanza to class action lawyers as it is certain that worse products will be in the market if deregulation occurs.

Regulation is also needed to ensure that consumers have access to information. In my written testimony, I listed eight consumer principles and standards for regulation that consumers use to determine if a State or Federal bill meets consumer needs.

The NAIC has moved fast to deregulate, since nothing motivates like the fear of loss of turf. However, we think they've gone too far in commercial insurance since small businesses, being not sophisticated, should have regulatory protections that now they have eliminated.

In personal lines, forms must be regulated, as I said, and rates, particularly risk classifications, should be regulated. These have profound impacts on people.

For example, a consumer's credit history now carries more weight in determining auto insurance premiums than driving record.

Another class being tested is global positioning satellites in autos. And what's next? Certainly health and life insurers will use the human genome to rate risks if they're not regulated.

One State stands out as having the best auto insurance regulation. Our study shows that California rates have fallen 12 percent since 1989, while in a typical State rates rose by 40 percent, and the profits for insurers were excellent, presents the best method.

So we ask Congress to carefully consider all the proposals you see before you to see if principles and standards that we've set out for consumer protection are part of any action you take. We would like to work with you, Mr. Chairman, on helping set those standards if, in fact, that is your desire.

[The prepared statement of J. Robert Hunter can be found on page 151 in the appendix.]

Chairman BAKER. Thank you very much, sir.

Mr. Philip R. O'Connor, President, PROactive Strategies, Inc., former Director of Insurance, Illinois Department of Insurance.

Welcome, Mr. O'Connor.

STATEMENT OF PHILIP R. O'CONNOR, Ph.D., PRESIDENT, PROACTIVE STRATEGIES, INC,. FORMER DIRECTOR OF INSURANCE, ILLINOIS DEPARTMENT OF INSURANCE

Mr. O'CONNOR. Thank you, Mr. Chairman, and thank you to the subcommittee, and especially thank you to your staff. They've put in a lot of hard work getting this hearing together very quickly, and I hope it is not unappreciated.

You know, this is probably the longest discussion that's ever been held anywhere on the Illinois system.

And I find it particularly interesting, because the Illinois system is not well-known and is not well-understood. When I came to the Illinois Department of Insurance in 1977 as the Director of Research, that was only 6 years into the process for the system that we have in Illinois today.

All that time, I undertook to conduct some research that was the first research of its kind to compare, as a group, competitive States with prior approval States. And similar research has been conducted now many times over in the subsequent years.

The academic conclusion of the research is pretty clear. There are really no benefits that flow from prior approval that you can't otherwise get, and there are actually a lot of opportunities for unintended consequences.

However, I'm going to admit to something here. In those early years of the Illinois system, I would say for the first 10 years, we were actually a little embarrassed by it. We felt a little bit like we were going to the NAIC meetings and our mothers had dressed us funny.

We were the only ones that really had no law dealing with property and casualty insurance rates.

And after I did my research, and after I served as director, I gradually did come to the conclusion that there was really no point in the entire ritual that was being engaged in around the country.

That is really the benefit of the Illinois system. We can go into more detail later as to what all the different features are that prevent consumer abuse in Illinois, but the basic thrust of it is that we rely on the antitrust laws, we rely on competition, we rely on strong market conduct and solvency regulation. In Illinois there is a focus on directing regulatory resources in a way that is more productive.

Virtually every important innovation in solvency regulation in this country has come out of Illinois in the past 25 to 30 years. We can go into that in more detail.

Let me comment briefly on Bob Hunter's reference to California.

Many of us have seen the Consumer Federation of America paper that Bob did, and I have no doubt that the conclusions in it are held by him and CFA very sincerely.

I have to disagree though on an important point. Everyone agrees the situation today in California is substantially better than it was in 1988 when Prop 103 passed. The question is how come?

The "how come" that I provide to you is that there have been a number of things in California that have gone directly to the underlying loss costs in the system that have come down.

These include the decision just before Prop 103 by the California Supreme Court to eliminate bad faith lawsuits by third parties. We've seen a variety of other things, whether it's California being the first State to go to primary enforcement of seatbelts, much more aggressive drunk driving enforcement and so forth.

So what's really happened in California in the last 10 years, after Prop 103, is it's taken about 10 years to get California pretty much back to its ranking a little bit higher than the middle of the pack in this country on auto insurance rates, just where it was about 5 or 6 years before Prop 103.

They had a terrible run up in costs in California. The public reacted. I think it was an incorrect diagnosis. But the issue deserves a lot of analysis and a lot of research.

One final point about California. There is a problem in a system when, for 10 years on a sustained basis, the return on net worth, that is the profit level in auto liability, is twice the national average.

Now I'm not against profits, but there is a difficulty there. That difficulty probably is a manifestation of the reluctance of the insurance companies to lower their rates voluntarily, when loss costs have come down, out of fear that once having lowered them, if costs go back up again, it will be a real problem trying to raise them to match those costs again.

And that's one of the inadvertent, unintended consequences of prior approval, whether it's in California or anywhere else. It creates so much uncertainty that it actually tends to drive up the cost of capital and makes companies more reluctant to do that which they would otherwise do in a competitive system.

So I would recommend that people look very closely at the Illinois system. It could fit on about two pages, both the statutes and the regulations that are associated with it. But over 30 years it's worked extraordinarily well.

[The prepared statement of Philip R. O'Connor can be found on page 174 in the appendix.]

Chairman BAKER. Thank you very much, Mr. O'Connor, and I do take great interest in the model and do wish to explore further an understanding of how it has functioned for consumer interest.

I do wish to have better in-depth understanding of the California model and the ramifications there, given the claims made by Mr. Hunter.

I'm going to facilitate this a bit, so that the other two Members might choose to pursue a couple lines of questions.

I have a couple of statements for anyone who chooses to respond in writing at a later time relative to my inquiry on the progress made to date by the State-led effort and the suggestion that we take CARFRA, CARFRA/NARAB, or some unknown standard yet to be determined, and establish that as the goal in some duration, 3 years, 4 years, 5 years, based on the presumption that earlier witnesses' testimony are correct. At least on the property and casualty side, there may be difficulties in moving toward more uniformity. Is there any advisability to that approach versus some, as another member suggested earlier in the hearing, is this really all about a national charter?

No, it's not. It is an attempt to find out how, I believe for consumer benefit, we standardize offerings and forms so you can compare product and see what prices really look like, which sometimes is complicated and difficult to do today.

And also, it is to expedite the entry of new products into the marketplace and not unreasonably restrain development of those products.

And if you would just get that back to us at your convenience, but obviously the sooner the better.

And then, Mr. Hunter, I want to let you know that I read everybody's testimony in advance of the hearing, and I read every line. I have some concerns, not as to your principal view nor the claims made with regard to the effort to unreasonably deregulate at the cost of the consumers' interest.

Mine goes more toward the statements concerning the subcommittee and NAIC. Page 2: "With regard to this hearing, consumers do care that insurers have been blatantly using the threat of congressional interest, including this hearing, to bludgeon the NAIC and the States into submission."

That parallels sort of the opening line of your testimony today. That would seem to indicate to me you think that, for whatever reason, I'm in some insurance agent's back pocket.

I don't expect a response. On page 5, I see: "NAIC had ample opportunity, after its own studies indicated a problem, to move in the direction of protecting consumers, but retreated when the industry threatened to cut off database funding, a primary source of NAIC funds."

If there's evidence of that, I want to know about it.

Third, page 7: "It is unfortunately clear that the NAIC approach is leading toward mindless deregulation."

I'm the last person in America to defend an insurance commissioner, given Louisiana's history, but I have to State on the record that I find that claim with regard to the 50 State regulators to be somewhat troublesome that they would be viewed as moving without any concern for consumers at all.

And then finally: "We ask Congress not to allow the industry to continue to use you as a threat to gain the mindless deregulatory changes they propose."

My point here is not to engage in a tit for tat kind of exchange with you at all. I just find these comments with regard to our process here and our intentions, particularly given the scope of your membership, to be problematic.

I do want to engage with consumer associations, all of them, not for the purpose of disenfranchising anyone to protect profits. I think other Members can assure you I have weighed into a number of topics of considerable controversy with perhaps a degree of enthusiasm that some Members have not enjoyed.

I will weigh into this one in the same manner, but I do not want the public record to have, on the face of it, a statement unanswered that appeared to go at the heart of our motivation, and I would yield to the gentleman if he should choose to respond.

Mr. HUNTER. I'll be happy to send you a letter with all the quotes that are being used by the industry. I never implied you, sir, or the subcommittee. I said the industry was using it that way, and I will be happy to send you the quotes.

Chairman BAKER. I would appreciate it. If I'm being used by somebody, I'm either stupid or I'm not aware of my circumstances. I yield back my time.

Ms. JONES. Thank you, Mr. Chairman. I will attempt to be brief. Mr. Hunter, I wanted to give you an opportunity, in my short amount of time, because you are the consumer advocate on this panel of wonderful insurance industry folks.

I don't mean to disparage anybody, but I want to give you a chance to respond to any of the statements by the other people that testified, Mr. Hunter.

Mr. HUNTER. Sure, there are a couple. I don't think we've been able to identify any products that haven't been able to get to market. I think there are probably very good reasons why a combined homeowners auto policy and for people over 49 years old was disapproved in a few States, but it could very well be discriminatory against poor people and younger people. And so I don't think that we've identified a product that hasn't gotten to market that maybe should have. I've heard a lot about 2-year delays and 3-year delays.

We've done some research on that. A lot of the delays are like this. A filing comes in. Thirty days later, some questions are asked. A year later the company responds, and then it's approved. Then the company complains it took over a year to approve a product. Well, it was in their control for a year. And that happens quite frequently. I won't get into an argument with my friend, Mr. O'Connor, about the California study except to say that my research covers the points he made, and I think I have shown that California is the best system for consumers and excellent for the industry as well.

Ms. JONES. Several of you have cited studies. Can you tell me the source and the funder of any of the studies that you have discussed that support your statements? I believe, again, sir with the white hair. I'm sorry, I can't see your name, because I left my glasses. I think you cited a study. Mr. Gowdy? Thank you. You cited a study, and also, sir, to the far right, you also cited a study that you support. Can you tell me who did these studies? Maybe if I used my list I might be better off. I apologize.

Mr. O'Connor and Mr. Gowdy both cited studies in their statements, and I was wondering who completed the studies and where and who funded the studies.

Mr. ZEMAN. I'll begin. Actually this is Bob Zeman, and it was in my testimony, both written——

Ms. JONES. Excuse me, Mr. Gowdy. Mr. Zeman. OK.

Mr. ZEMAN. I briefly reference the number of academic studies. They were produced by a number of well-known professors, including Professor Scott Harrington from the University of South Carolina and Professor Darcy from the University of Illinois.

Ms. JONES. Do you know who funded either of those studies?

Mr. ZEMAN. As far as I know, they were actually funded by the universities and also in conjunction—some of these were done by the Brookings Institution as well.

Mr. O'CONNOR. Congresswoman, there are studies over the 30 years that have looked at the question: "Is market performance better under competitive laws versus prior approval?"

The first of those studies was actually financed primarily by State insurance departments. These were the studies that were conducted in the later 1970's. I did one of the first ones at the Illinois Insurance Department as a Research Director.

A large number of studies were done in that context.

Following that period of time, the insurance industry, either individual companies or some of the trade associations, would finance some of these studies.

The General Accounting Office performed one or two of these. More recently, there have been a combination, I believe, some in the States, some by industry funded by companies, some by academics and so forth. And then in the more recent Brookings Institution ones, I believe that there may have been some company contributions to Brookings.

Certainly in my own studies that I've done over the years, I was never asked to find any particular thing. It is fair to say that my original work, done at the Illinois Insurance Department, led to convincing, a, myself; b, ended up convincing the National Association of Insurance Commissioners. We ended up putting out a model bill in 1981 on competitive rating. We actually ended up convincing the industry, which was very skeptical when it came to worker's compensation price competition, which many of them adamantly opposed, and which we achieved in Illinois in 1982. So it's kind of a real mix.

Ms. JONES. Thank you. Let the record be clear that I did not infer that any findings of any of the studies were asked for in any particular way.

I come from a legal background as a judge and a prosecutor, and that's always an appropriate question when someone says they produced a study to find out who wrote it and who did it.

Mr. O'CONNOR. My mother always likes me to keep my skirts clean on these things.

Ms. JONES. I'm out of time. But if the Chairman will allow you to respond, I'd be glad to hear your answer.

Mr. GOWDY. Congresswoman, the study I referred to was done by Professor Butler at Brigham Young, that was, I think, funded by the Brookings Institute. Amongst its findings was a ranking of States by how long they took to approve various forms and rate filings.

And as the Chairman noted, Louisiana—pardon?

Ms. JONES. Where was Ohio?

Mr. GOWDY. Ohio was in the middle.

[Laughter.]

Mr. GOWDY. I think Louisiana did take the top rank, and your Chairman cited some of the numbers from that study.

Ms. JONES. Thank you, sir. Thank you, Mr. Chairman.

Chairman BAKER. Yes, ma'am. Ohio was number 19. Louisiana was number one with an average across all lines of 222.7 days. Ohio had an average of 80.0 days. So once again, you've excelled greatly in your achievement.

[Laughter.]

Chairman BAKER. Mrs. Biggert.

Mrs. BIGGERT: Thank you, Mr. Chairman.

Once again I'd like to welcome someone from Illinois. As State Representative, Terry Parke is the insurance guru of Illinois, I think I'd have to ask the question, what does that make Phil O'Connor? I guess it would be the Grand Pubah of insurance in Illinois.

I also had the opportunity to work with him when he was head of the Commission where we created the Human Service Agency in the State of Illinois. So he's done an awful lot for the State, and I welcome him here.

My question is, it's my experience that Illinois consumers have been very accepting. I know there was some reference that consumers don't really care what kind of regulation there is, but they've been accepting of the Illinois regulation structure because we, as State legislators, when I was there and Representative Parke testified, that there really is nothing brought forward to the State legislature to change the system.

Could you tell us in your experience if you think that's the case? Are consumers concerned about how insurance is regulated in Illinois or not regulated?

Mr. O'CONNOR. Let's face it. Nobody's crazy about insurance, OK? We don't really like buying it. We don't like to have to deal with it when there's a claim, but we're sure glad we have it. When we do want to buy it, we want to have a fair price.

I think generally speaking in Illinois, things have worked well. The issue hasn't risen to a high degree of controversy I'd say in about 20 years.

The last time we had a controversy in Illinois, it was a very abbreviated one. It was in 1986 and 1987. And it really had to do with liability insurance for things like day-care centers, municipalities and so forth.

I'll give you one example. One of the things that the competitive rating situation in Illinois has forced regulators and the General Assembly to do is to be much more creative about dealing with problems rather than simply resorting to price regulation. That's why in the late 1970s and early 1980s, Illinois was the first and, I would submit, to this day has done the best job of dealing with the problem of urban insurance availability.

This goes to the question Bob Hunter was dealing with about products not getting to market. A lot of States had a heck of a time or companies had a heck of a time in some States getting to market new homeowners products that dealt with the problem of the replacement cost of a home, if it burned down, being much greater than the market value. So they were very reluctant to write homeowners policies on such a home because, by golly, if it burned down it would cost $200,000 to replace it. You'd have to do a cash settlement, while the market value might be $50,000.

So in Illinois what we came up with and pushed the companies toward was a policy that fixed the house or gave you the market value. This, among other things, really solved the problem in Illinois, to this day, of availability of conventional homeowners insurance in every neighborhood in the city of Chicago.

And I think that was one of the good things about not having rate regulation. We had to think of real solutions rather than dream up something with rate regulation they made everybody happy for a short period.

Mrs. BIGGERT. Right. Thank you. And I did want to also ask a question of Rita Nowak who is here. I'm also delighted to welcome her, because she's one of my constituents from Downers Grove, Illinois.

Ms. NOWAK. Thank you.

Mrs. BIGGERT. Again, welcome to you. We've been talking a lot about the regulatory variances that occur State by State, but I understand that there are also variances within a State based on the individual lines of businesses. How much does this lack of uniformity across product lines cost insurance companies in terms of approval time?

Ms. NOWAK. The variances within a State by product line probably are not costing insurers a significant amount of money at this point in time.

Normally the variances are between personalized and commercial line products. With commercial line products, the regulations are a little bit broader, a little bit easier to deal with. In the commercial lines regulatory environment, you're going to find more file and use in forms, more open competition on the rate side.

On the personal lines side, they're more restrictive.

Companies are aware of that. They're looking for functionality here. If they understand the functionality of the law and how it works, then they're able to file their products and then subsequently get them approved.

Mrs. BIGGERT. So you don't see that we need to really address the problem yet?

Ms. NOWAK. At this point, from our members' perspective, at least from the Alliance perspective, they have not identified that as a critical issue.

What our members are looking at is functionality. If it's a prior approval let's say for a personal automobile, we should still be able to see that product get approved within 30 days. They're looking for functionality.

Mrs. BIGGERT. Thank you.

Mr. GOWDY. May I respond to that?

Mrs. BIGGERT. Absolutely.

Mr. GOWDY. From the AIA member companies, this is a problem for us. The CARFRA example that was used by NAIC applied only to life products at this point in time. There is really no similar standardization process that's going on in the property casualty area, other than this attempt to produce the rules and get these desk type standards out on the table and get them into a manual.

Massachusetts tried it for just one product, and their manual for one product was three inches thick.

This is a major problem of rules being onerous, rules being different in terms of what it takes to file and approve a form or a rate in either commercial lines or personal lines.

Mrs. BIGGERT. And do you have some possible solutions to this problem?

Mr. GOWDY. I think it's absolutely necessary that we let the marketplace play a bigger role and try to keep the rules and standards to the things that are important such as financial solvency. The States have not done a very good job, and we have many examples of that. And market conduct. And there again, I think we can improve upon that dramatically.

Mrs. BIGGERT. Thank you. I see my time is up. Thank you, Mr. Chairman.

Chairman BAKER. Thank you, Mrs. Biggert.

Unless there are further questions, I want to thank each of you for your patience in wading through a lengthy hearing this afternoon and for your participation.

We will keep the hearing record open for an additional 30 days longer than usual in order to facilitate your answers to prior questions. And I'm informed Members also may be forwarding additional questions for you to consider.

And if you have additional perspectives you'd like to offer in light of the proceedings, we would welcome those as well.

Thank you very much. The hearing is adjourned.

[Whereupon, at 5:05 p.m., the hearing was adjourned.]

APPENDIX

June 21, 2001

EXCHANGE

Subcommittee on Capital Markets

Richard H. Baker, Chairman

Securities, Insurance, Government-Sponsored Enterprises

The News from U.S. Rep. Richard H. Baker
Sixth District, Louisiana
FOR IMMEDIATE RELEASE: June 21, 2001
CONTACT: Michael DiResto, 225-929-7711

Opening Statement
The Honorable Richard H. Baker, Chairman
House Financial Services Committee Subcommittee on
Capital Markets, Insurance and Government Sponsored Enterprises
Hearing, June 21, 2001
"Insurance Product Approval: The Need for Modernization"

Today marks the second in a series of hearings this Subcommittee will undertake on insurance reform. Our current hearing will focus on the need to modernize insurance product approval.

Unlike the rest of the financial services industry, insurers are subject to a patchwork quilt of State regulation. In many States, insurance products are not only subject to prior approval of the policy language, or form approval, but also to strict regulation of prices, or rate approval, for property/casualty products.

These time delays for form and rate approvals vary widely from State to State. A national rollout of a new product can take years, with consumer costs increasing at each step in the 50 State approval process.

Why should consumers have to wait for the lowest-common-denominator State to finish its review before they can have access to a nationwide product? Consumers in all States are being harmed by excessive regulatory bureaucracy in the worst States that either can't or won't get their act together.

In the life insurance industry there are twelve States, which I will call the "Dirty Dozen," that routinely drop new products into bureaucratic black holes for approval. These States are New York, New Jersey, California, Massachusetts, Maryland, Connecticut, Florida, Oregon, Pennsylvania, South Carolina, Texas, and Vermont.

For example, companies have reported approval time delays of 391 days in Massachusetts, 399 days in Texas, and 442 days in Pennsylvania for a universal life insurance product. I may be a slow reader, but it certainly doesn't take me 442 days to read an insurance policy.

Approval of property/casualty products is no better. There are eight States which I will call the "Not so Great Eight": New Jersey, Massachusetts, my own state of Louisiana, Hawaii, Rhode Island, Delaware, California, and Pennsylvania.

For example, Louisiana has reportedly lost 16 insurance companies in the first half of this year due to slow product approval. One company doing business in the State has reported <u>average</u> approval delays of 305 days for new liability insurance products. This is untenable. A bill reforming product regulation is currently moving through the legislative process in Louisiana. I am hopeful that it will pass, but this does nothing for consumers in other States.

In New Jersey last week, their biggest automobile insurer, State Farm, decided to pull out of their market because the rate reviews had become so onerous and politicized. It is reported that since September, 1999, State Farm has lost almost a quarter of a billion dollars, cutting the company's net worth almost in half.

Just this week, one of the largest insurers in the world, AIG, also decided to exit the New Jersey market due to their excessive regulation and price controls. As a result of these decisions, in excess of **1 million** New Jersey drivers will need to find new coverage at likely higher rates. That is more than **one out of every five** drivers in New Jersey who will lose their coverage.

Today, the fourth largest writer of automobile insurance in New Jersey, Liberty Mutual, is also talking about abandoning the automobile market. That could mean another **half a million** drivers without coverage. New Jersey already has the highest automobile rates in the country. It is only going to get worse.

In fact, according to figures provided by the American Insurance Association, the twenty-seven States with very stringent price controls were the most expensive States for auto insurance consumers, with annual expenditures averaging $695. Additionally, consumers in those States are not allowed to get coverage from those companies driven out of the market. It is a lose-lose for consumers.

The States are not without some success stories, however. Colorado and Michigan are known for their efficient review of both life and property/casualty policy forms giving consumers access to new products quickly without sacrificing consumer protections.

Illinois has been successfully following a market-oriented approach in the regulation of its auto insurance market for 30 years. In Illinois there are more insurers competing for business giving consumers ample choices, rates are relatively low, and there are few uninsured drivers. Wisconsin has also experienced success with a more market-oriented approach.

Of course, this begs the question, why are these States not being used as models for reform? I am anxious to hear what the NAIC and the National Conference of Insurance Legislators have to say in that regard. The bottom line is that reform is needed and the clock is ticking.

I would like to thank all of the witnesses appearing before the Subcommittee today.

-30-

www.house.gov/baker

Statement from Acting Commissioner Wooley

One of the major functions of the Louisiana Insurance Rating Commission is to make reliable, affordable insurance available to the consumer. The Commission is mandated to accomplish this by ensuring that insurance companies charge adequate, but not excessive, rates. Yet, within the past year, 16 companies have restricted sales or completely left the state, with several of them indicating that they can't continue to do business in Louisiana because they have been unable to get adequate rates approved by the La. Rating Commission.

Losing 16 companies, more than 3% of the total private passenger automobile market, in such a short period of time is an alarming and unprecedented trend that must be addressed. These companies represent more than 3 % of the total auto ins. market, total some 175,000 policies, and bring in almost $63 million premium dollars each year.

It is a known fact that a company must collect sufficient funds to pay its claims and stay in business. If they don't, that may become insolvent. You may recall that in the late 80s more than 20 Louisiana insurance companies went bankrupt, largely because of inadequate rates and related factors.

The bottom line is that insurance companies are leaving Louisiana because of the "prior approval" system that is overseen by a politically appointed board. This system is clearly slowing down the speed with which companies can respond to the marketplace—and the system must be changed. This is why the Louisiana Department of Insurance worked with the insurance industry and consumers to develop a move to a "file and use" system. Such a system adds speed to the ability to market new products and services. We at the Department of Insurance are committed to continuing our efforts to remove barriers and restrictions to competition in the Louisiana insurance marketplace.

company	$	%	# of policies
First American	4,279,386	0.21%	12,215
Mutual Service	8,970,292	0.43%	19,492
American Colonial	7,628,778	0.37%	10,497
Clarendon	1,467,748	0.07%	389
Deerbrook	1,390,759	0.07%	3,539
Diamond State	43,491	0.00%	224
Fidelity First	(199,119)	-0.01%	-
Independent Fire	3,395,788	0.16%	2,910
Permanent General	9,818,006	0.47%	21,674
Millers	2,203,336	0.11%	3,658
TIG	2,823,870	0.14%	36,091
United National	-	0.00%	-
Commercial Union	-	0.00%	-
Financial Indemnity	4,452,043	0.21%	6,500
United Auto	5,207,571	0.25%	13,837
Nobel	10,896,496	0.52%	41,990
subtotal	62,378,445	2.99%	173,016
total	2,084,111,040		

Sixteen companies that withdrew new business in Louisiana marketplace in the past year.
Private passenger figures only. Actual figures are higher because the Department does not have numbers for the two surplus lines companies, Commercial Union and United National.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
June 22, 2001

"Insurance Product Approval: The Need for Modernization"

Chairman Baker, thank you for holding this hearing today.

I am pleased that this Subcommittee is reviewing the need for modernization and reform in our current system of insurance product approval.

Insurers are subject to the jurisdiction of over 50 different State regulators, each with its own set of rules and regulations. Companies have to navigate their way through a mind-numbing maze of conflicting regulatory requirements to offer products to consumers.

The current patchwork system for insurance regulation imposes significant, unnecessary costs on insurers and results in unnecessary delays in getting new products to market. Ultimately, the consumer bears the cost of this bureaucratic morass, facing higher prices and product unavailability.

Other financial industries in the U.S., such as banking and securities, do not face significant delays. Those products get approved either immediately or for some securities products, within a few months. In contrast, companies trying to plan a nationwide rollout for new insurance products have sometimes faced delays of up to 2 years. This is untenable.

Over the last several years I have asked the National Association of Insurance Commissioners to focus on this glaring problem. By all accounts, the NAIC has made some progress, and I applaud their efforts. In particular I would like to thank the Director of Insurance of my home State of Ohio, Lee Covington, who has been a great leader for the NAIC on state-based reform of the product approval process. I would also like to commend Commissioner Frank Fitzgerald of Michigan. Both commissioners have agreed to join us today to report back on the NAIC's efforts.

Make no mistake about it, true reform is necessary. It is my hope that our State legislators and insurance commissioners can enact such reform. If not, Congress will return to this issue with our own solution.

While the NAIC has moved ahead with two initiatives, one for life insurance and one for property/casualty insurance, the jury is still out on the effectiveness of these programs. In fact, we will hear from a number of witnesses today who will say these initiatives don't go far enough and are a long way from reforming the system.

Chairman Baker, I appreciate your continued leadership on this Subcommittee to help us understand the problems facing the insurance industry and insurance consumers. I look forward to the Committee's continued work in this area.

I yield back the balance of my time.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON INSURANCE PRODUCT APPROVAL: THE NEED FOR MODERNIZATION

THURSDAY, JUNE 21, 2001

Mr. Chairman, thank you for the opportunity to comment before we begin our hearing on the insurance product approval process and the need for modernization. I commend you for your continued interest in the current issues affecting the insurance industry and your commitment to educating the Members of our Committee about these matters.

Presently, a tangled web of regulations often slows the ability of insurance companies to introduce new products nationwide to the pace of baby steps. This sluggishness in new product and rate approval by insurance regulators frequently creates competitiveness concerns for insurance companies. The insurance industry has consequently contended for a number of years that we need to design and implement a new regulatory system to straighten out this regulatory labyrinth, better the quality and timeliness of filing reviews, and improve competition. If sensibly put into practice, these actions should ultimately benefit consumers by increasing their choice of and lowering their rates for insurance products.

The National Association of Insurance Commissioners has created its Speed to Market Working Group to respond to these concerns. This group, as I understand, is seeking to develop and implement state-based, uniform standards for policy form-and-rate filings for appropriate product lines. The NAIC hopes that this initiative will shorten the length of the "prior approval" process and lower the costs involved in reviewing and approving rates and policy forms in the states and territories. As part of the initiative, the NAIC has divided its work among two subgroups. They are the Improvements to State-Based Systems Subgroup and the Coordinated Advertising, Rate, and Form Review Authority Subgroup, otherwise known as CARFRA.

CARFRA is working to streamline the review process for rates and forms, particularly for life and health products. CARFRA hopes one day to provide insurers with a single point for product filings and establish a coordinated regulatory review process among insurance regulators. Currently, ten states, including my home state of Pennsylvania, are piloting a CARFRA project, and the NAIC hopes to launch the system nationally by May of next year.

In my view, the need to update and streamline our nation's insurance regulations and laws has become increasingly apparent, especially in the wake of 1999's law to modernize our nation's financial services industry. Not surprisingly, our current insurance regulatory system -- with more than fifty separate jurisdictions -- often delays the nationwide introduction of new products. Executives at some insurance companies have previously noted that it can take 18 months or longer to obtain the necessary approvals to sell a new insurance policy or annuity on a national basis.

In our dynamic economy, rare is it that the slow are rewarded. The insurance industry is certainly no exception to this aphorism. We should, therefore, work to improve the efficiency and effectiveness of the regulatory system for insurance. In the months ahead, I will therefore continue to keep a watchful eye on the NAIC's speed to market initiative and examine its effects on both companies and consumers. We may additionally need to pursue complementary reforms in the insurance industry at the federal level. It is also my sincere hope that as we continue in our efforts to modernize insurance regulation we will work to provide adequate and appropriate safeguards to protect the interests of individual consumers.

In closing, Mr. Chairman, I believe it important that we learn more about the views of the parties testifying before us today, and if necessary, work to further refine and improve the legal structures governing our nation's insurance system. I also look forward to hearing from our witnesses about their impressions and to working with you in the future on insurance issues like this one and achieving nationwide uniformity in agent licensing.

Testimony of the
CARFRA Working Group
and the
Improvements to State-based Systems Working Group
of the
National Association of Insurance Commissioners

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

Hearing on:
Insurance Product Approval: The Need for Modernization

June 21, 2001

Frank M. Fitzgerald
Commissioner of Insurance, Michigan
and
J. Lee Covington II
Director of Insurance, Ohio

Testimony of Frank M. Fitzgerald, Chair
NAIC CARFRA Working Group
And
J. Lee Covington II, Chair
NAIC Improvements to State-based Systems Working Group

Introduction

Chairman Baker and members of the Subcommittee, my name is Frank Fitzgerald. I am the Commissioner of the Department of Consumer and Industry Services Office of Financial and Insurance Services. I serve as Chair of the National Association of Insurance Commissioners (NAIC) Financial Services Modernization Task Force and the Coordinated Advertising, Rate, and Form Review Authority Working Group (CARFRA). Joining me today is Lee Covington, Director of Insurance in the State of Ohio. Director Covington serves as Chair of the NAIC Regulatory Re-engineering Task Force, and the Speed to Market—Improvements to State Based Systems Working Group.

Thank you for inviting us to testify regarding the efforts of state insurance regulators, in our own states and through our work as members of the NAIC, to modernize state insurance regulation in the area of product regulation through our Speed to Market Initiatives.

During a Subcommittee hearing on July 20, 2000, Chairman Oxley noted that insurance commissioners, through their "Statement of Intent," "have demonstrated now that they can "talk the talk"; if they can also "walk the walk," then insurance consumers and producers can fully benefit from uniformity without the need for a new federal system." Further, Chairman Oxley "hope[d] that the NAIC working groups [would] not only be able to come up with specific proposals for achieving their goals, but to attach specific time frames to implement those proposals in the 50 States." Product speed to market has been slated by commissioners and industry representatives as one of the highest priorities outlined in the NAIC Statement of Intent. I am excited to report that state insurance regulators remain strongly committed to the product speed to market modernization initiative with unprecedented consensus, and we have accomplished just what this Committee had hoped to see—specific proposals that are now in the implementation process. In just over one (1) year, the NAIC established a vision for modernizing insurance regulation, developed a new and innovative plan for product speed to market, and is now implementing a speed to market plan with extraordinary quickness. We applaud the intense work and commitment of each state insurance commissioner as we have moved forward in our Speed to Market initiatives.

Background

Insurance has been regulated in part because it is a business that is selling a promise to the public that it will be there in time of need. Since the customer receives an intangible product that requires the utmost trust and good faith, state insurance regulators have traditionally been called upon to monitor both the financial performance of insurers and how insurers treat their policyholders. The subject of today's hearing, product regulation and speed to market, relates to an element of market regulation and the treatment of policyholders. State insurance regulators have dedicated staff who read insurance contracts to ensure compliance with applicable state and federal laws because many consumers either choose not to read their policies or cannot understand the legal complexities of the their policies. If the policy language does not comport with state law, a consumer is unlikely to know whether the policy complies with the law at the time a claim is filed and may not receive all the benefits to which the consumer is entitled under the law. States also have staff who are asked to review insurance rating systems to make sure that insurance rates are not excessive, inadequate, or unfairly discriminatory, and to ensure that premiums are reasonable in relationship to the benefits provided.

As the insurance business has evolved, state insurance regulators have acknowledged that traditional methods of insurance regulation need to be modernized to allow the insurance industry to keep pace with its competitors, and to ensure insurance regulators are able adequately serve the best interests of insurance consumers. In the area of product regulation, insurance regulators recognize that historically, it has taken far too long to introduce new insurance products in all 50 states. This is not good for consumers or the insurance industry. Therefore, the NAIC has made its Speed to Market Initiative one of its highest priorities. The Speed to Market Initiative is aimed at improving the timeliness and quality of the reviews given to insurer filings of insurance products and corresponding advertising and rating systems. While the filing and review process is an important element of consumer protection, it is incumbent upon states to react to insurer filings in a timely and expedient fashion. It is also important to provide consumer with access to beneficial products at the earliest possible time.

The NAIC's Speed to Market Working Group was formed in March 2000 to evaluate insurer's contentions that the state-based insurance regulatory system places them at a competitive disadvantage with other financial services sectors because it takes too long for insurers to bring new products to market. The task facing the Speed to Market Working Group was to decide how multi-state regulatory processes and procedures might be integrated with individual state regulatory requirements to provide a timely and responsive regulatory environment for insurers and insurance consumers. In order to keep insurers competitive with other financial service entities and allow consumers to purchase beneficial insurance products, this working group was challenged to find an acceptable combination of timely and quality reviews with appropriate consumer protections.

The working group quickly came to realize that not all insurers were unhappy with state-based regulation and that the motivation for change from different parts of the insurance industry often depended upon whether they faced direct competition from financial institutions and securities firms, or not. Further, consumer interests were very wary of any change that might be perceived to lessen consumer protections.

NAIC Speed to Market Initiatives—CARFRA and Improvements to State Based Systems

To meet the challenges that they faced, the Speed to Market Working Group developed two distinct proposals. In recognition of the distinct efforts that would be required to implement the two separate solutions, the NAIC, in March 2001, divided the Speed to Market Working Group into two separate working groups. The CARFRA Working Group is now charged with oversight of the CARFRA project that will be described later. The Improvements to State-Based Systems Working Group was asked to oversee implementation of the operational and regulatory framework efficiencies that were identified in the Speed to Market Implementation Plan (Dec. 2000—See Appendix). The Improvements to State-Based Systems and CARFRA proposals create timelines and meet the NAIC efficiency goals. These proposals include a phase-in implementation product review timeline of 45-days for industry and regulators alike, with a reduction to 30-days over time.

Before the Improvements to State-Based System initiative and the work on CARFRA are discussed in detail, it is important to be aware of an NAIC initiative that has been developed to provide an electronic system for submission of rate, policy form, and advertising materials. The System for Electronic Rate and Form Filing (SERFF) provides a viable electronic alternative for insurers to meet their rate, policy form, and advertising material filing requirements with state insurance regulators.

SERFF (System for Electronic Rate and Form Filing)

The SERFF system is a robust Internet-Based electronic system that is being implemented in all states as the electronic framework for the NAIC's speed to market initiatives. The evolution of SERFF into the system it is today will enable the NAIC and states to implement their Speed to Market Initiatives. Currently, more than 200 insurers participate on the system, and this number is sure to grow with the NAIC's plan to fully implement SERFF in all 51 jurisdictions. In February of this year, the NAIC membership recognized SERFF as a vital tool that must be in place in all states, and therefore, appropriated $1 Million to fund completion of the implementation plan on an expedited schedule. Currently, 46 states are participating in SERFF and while not all of these states are actively receiving filings, the NAIC's plan calls for active filing status in at least 41 states by the end of 2001, with the remaining states being added in 2002. The NAIC is currently ahead of the implementation schedule and remains extremely optimistic about meeting the deadlines or finishing the project ahead of schedule.

The SERFF system offers a number of advantages for regulators and insurance companies seeking to get products to market in a timely manner, including:

1. The SERFF system serves as the conduit for multiple states to participate in the CARFRA single point of filing system by enabling multi-state product review panels to review a filing through state of the art electronic communications;

2. For products not reviewed through the CARFRA system, including most property and casualty products at this point, the SERFF system allows an insurer to file the product in all states with the touch of a button, as well as:
    - Serving as a gateway to ensure the filing is complete;
    - Allowing an insurer to track the filing during the review process;
    - Providing electronic communications capabilities for state and insurers while the filing is under review;
    - Providing electronic efficiencies during the regulatory review process, such as the ability for more than one person to review the filing;
    - Monitoring the performance of states' adherence to established timeframes and insurers' compliance with the legal requirements for products.

SERFF offers insurers a way to effectively communicate with insurance regulators in an environment that enhances the speed, accuracy and consistency of filing reviews. SERFF will allow all states to implement the best practices identified by the NAIC and industry representatives, and serves as the infrastructure necessary to accomplish the Speed to Market Initiatives. The SERFF system will be mentioned throughout the discussion of CARFRA and the improvements to state-based systems initiative.

CARFRA

This proposal is intended to address concerns about direct competition with other financial services sector companies. The Speed to Market Working Group recommended the development of a system featuring a single point of filing and review, national standards for insurance products, and an efficient state-based procedure for processing the filing. The CARFRA Working Group has assumed the development of this single point of filing process.

The Coordinated Advertising, Rate and Form Review Authority (CARFRA) process began in May 2001 with a limited launch that initially focuses on life and health products. It is the life insurers that are most directly affected by competition from other sectors providing investment type products. The working group believes that CARFRA can also benefit certain property and casualty products and will expand the process accordingly in the future.

The limited launch of CARFRA meets consumers' needs by speeding new products to market while maintaining appropriate regulatory standards of review. CARFRA gives insurers a single point of entry to submit products for review, with the certainty that a filing can be approved for multiple state use within an established number of days.

CARFRA will not require states to slow down or regress in their current processes. For instance, if a participating state is a file and use state, a CARFRA filing can be used immediately in that state upon filing. CARFRA can accommodate a variety of regulatory approaches, not just prior approval.

The limited launch of CARFRA began its part of the regulatory re-engineering process on May 1, 2001. Starting with a focus on life and health products, the limited launch allows insurers to make one filing that will be reviewed based on a set of national standards, together with certifications to state deviations, and receive action from each participating state within 45 days of filing. Future plans call for a 30-day turnaround time.

The basic plan of operation for a CARFRA limited launch was developed by the CARFRA subgroup of the Speed to Market Working Group. The CARFRA Subgroup consisted of six states: Maine, Michigan, New York, Oregon, Pennsylvania, and Texas. The states of Alabama, Arkansas, Indiana and Ohio were added prior to the limited launch on May 1, 2001. The ten (10) states form the core states that will accept and review filings during the early limited launch period. There are other states that serve of CARFRA Working Group so that they can be involved in development of national standards and keep up to date on CARFRA developments.

The purpose of the CARFRA limited launch is:

- To implement, on a limited launch basis, the CARFRA process as a prelude to full implementation of the process;
- To determine the best method for teams to coordinate review and reach consensus agreement on Advisory Recommendations for the participating states;
- To provide information toward accomplishing a long-term goal of identifying best practices that can be legislatively implemented in individual states for greater uniformity;
- To increase the efficiencies, expertise and transparency applied to the review process; and
- To allow implementation of CARFRA on a national basis within a year of the completion of the limited launch.

Improvements to State-Based Systems

The Speed to Market--Improvements to State Based Systems Plan approved by the full NAIC in December 2000, calls for states to implement a plan whereby all insurance products not reviewed by CARFRA, including most property and casualty products at this point, will be reviewed within a 30-day period of time, unless a regulator or insurer requests an additional 30-days in exceptional circumstances. Further, the plan calls for the implementation of an informational filing system, or competitive rating system, for all commercial lines rates.

This plan grew out of the Statement of Intent signed by all Commissioners in March 2000, stating as follows:

> [W]e will take steps to improve speed to market for insurance products. . . . For lines that do not lend themselves to uniform standards, we are committed to reviewing market barriers for further efficiencies. We will also develop an e-repository for filings, a system for tracking data, and a state certification process.
>
> In addition, we will take steps to shift the focus of states away from a prior approval system, where appropriate.
>
> We will continue to explore avenues to reduce unnecessary requirements for policies sold to insurance purchasers with insurance knowledge and market power. Where appropriate, we will explore increased reliance on the benefits of open competition.

The Statement of Intent regarding Speed to Market was further refined in the Vision Statement released by the Speed to Market Working Group in September 2000. In the Vision Statement, the Speed to Market Working Group recognized that not all products will be reviewed by CARFRA. Further, NAIC made a decision that CARFRA will be voluntary for insurers so an insurer may elect to make its filings through the traditional state filing methods or through CARFRA. Thus, there will continue to be traditional state-based filings and the NAIC committed to improving the traditional state based system by adopting a plan encompassing the best practices used by states across the country.

To that end, the working group, in its Vision Statement, charged the Improvements to State-Based Systems Working Group to further develop a number of recommendations, including

- Review of regulatory requirements to determine if they are essential to provide necessary consumer protections and eliminate those that fail to meet this test and are no longer necessary;
- Evaluate the need for prior approval requirements and consider implementing systems that rely more on competition than rate regulation to protect consumers;

From the charges presented by the Speed to Market Working Group, the Improvements to State-Based Systems Working Group developed its goal to create a more efficient state-based filing and review process that provides for consumer protection while offering uniform and consistent speed to market for insurers and consumers. It also developed four objectives to meet that goal:

- Identify operational efficiencies and best practices that states can implement to improve the timeliness, quality and consistency of rate filing review.
- Identify operational efficiencies and best practices that states can implement to improve the timeliness, quality and consistency of form filing review.
- Identify alternatives to current regulatory processes that will offer speed to market for insurers; and
- Identify essential consumer safeguards relative to the rate, rating manual and form review process, identify and promote the adoption of absent consumer safeguards and promote beneficially competitive markets.

After over 10 meetings in just two (2) months, the Improvements to State-Based Systems Working Group developed a detailed set of recommendations for operational efficiencies and regulatory framework efficiencies that was approved by the full NAIC in December 2000. These efficiencies or best practices, along with the CARFRA Initiative, are contained in the NAIC Speed to Market Implementation Plan.

In sum, the Plan calls for a 30-day review period for introduction of a product on a nationwide basis and an informational/competitive rating system for most commercial lines rates. This plan is accomplished through the two-part plan--Operational Efficiencies (i.e. Best Practices) for all insurance products and Regulatory Framework Efficiencies for Commercial Lines Products. With respect to Operation efficiencies, the Plan details a four-step process for creating a 30 day nationwide review system:

1. **Review Standards Checklists and Transmittal Forms:** A best practice identified by the NAIC is the development of clear guidelines based on state law for products sold in each state. The State of Colorado estimates that prior to the development of review standards checklists, less than 20% of filed products complied with Colorado law and where able to be introduced within 30 days. After the institution of checklists, over 90% of their product filings complied with Colorado law and were able to be introduced within 30 days of filing.

   According to the most recent report, in just five (5) months since release of the Plan, over 28 states, representing 50% of the United States insurance market, report that 100% completion of the checklists will be achieved by the end of June, and we continue to receive reports that additional states expect completion by that time. These checklists are scheduled for release on the NAIC website by June 30th. We are well on our way to our goal to have all states completed in 2001;

The checklist and the review standards have a number of intended purposes:

- Provide clear expectations for insurers as to the requirements for product filings.
- Enhance speed and uniformity of review by individual insurance departments.
- Provide a starting point for a process aimed at eliminating inconsistencies between state filing requirements where appropriate and eliminating regulations and policies not necessary to achieve regulatory purposes.
- Assist CARFRA in identifying products with common filing requirements for purposes of determining products that can be reviewed by CARFRA.

2. **SERFF Implementation:** As stated above, in February of this year, the NAIC membership recognized SERFF as a vital tool that must be in place in all states, and therefore, appropriated $1 Million to fund completion of the implementation plan on an expedited schedule. Currently, 46 states are participating in SERFF and while not all of these states are actively receiving filings, the NAIC's plan calls for active filing status in at least 41 states by the end of 2001, with the remaining states being added in 2002. The NAIC is currently ahead of the implementation schedule and remains extremely optimistic about meeting the deadlines or finishing the project ahead of schedule.

3. **Uniformity and Consistency among State Filing Requirements:** The Plan calls on States, to the greatest extent possible, to create consistency and uniformity among state filing requirements by:

   - Eliminating all department policies/desk drawer rules not based on a state law or regulation.

- Eliminating regulatory requirements that do not achieve the regulatory purposes set forth in state law.
- Maintaining and adding uniform regulations that are necessary to achieve the regulatory purposes set forth in the proposed Property and Casualty Model.
- Making remaining regulations as uniform as possible. The Speed to Market Working group should be charged with developing a self-assessment guide to standardizing regulations or taking other appropriate action aimed at standardizing the regulations existing in each state to the extent possible by December 2001.

Implementation of this phase of the project will begin after completion of the Review Standards Checklists.

4. **Review and Compliance Timeframe—30-Days:** The Plan calls for implementation of an operational standard requiring the entire filing and approval process to be completed within 30-days, with an a one time thirty-day extension at the insurer or state's request in exceptional circumstances. The SERFF system will be used to monitor compliance with the operational standard.

With respect to the Regulatory Framework Efficiencies for Commercial Lines products, the Plan provides for implementation of a no filing system for selected commercial lines rates and an informational/competitive rating system for most commercial lines rates. With regard to commercial lines forms, the Plan provides for a file and use system. Currently, four (4) states have a system similar to the system outlined in the plan, and 15 states have been granted the discretionary authority through legislation to move to this type of system. The Plan calls on those 15 states to move to this system at the earliest possible time. For the remaining states, legislation will be required, and at this point, because most legislatures have adjourned for the year, legislative action will be required in 2002.

In regard to the Regulatory Framework Efficiencies for Personal Lines Insurance under the Speed to Market Plan, during 2001, the Improvement to State Based System Working Group will be "study[ing] all issues relating to personal lines rate and form regulatory system, including but not limited to whether a file and use system or flex rating system should replace prior approval systems" and consideration of "deregulation and competitive rating for personal lines rates . . . ." The Working group held its first meeting on this issue in May, where the Working Group heard from more than 18 panelists during a day and half period, representing insurance departments, insurers, consumer groups, and academic institutions. The NAIC expects to hold several other meetings this year on this issue in its efforts, in appropriate circumstances, to move away from prior approval requirements and toward implementing systems that rely more on competition.

Long Term Goals for CARFRA and State-Based Improvements

The CARFRA Working Group has the following short-term and long-term goals:

- Continue to run the CARFRA limited launch for one year;
- Select the next group of products for which it will develop national standards by July 1, 2001;
- Add several more states to the CARFRA limited launch during the second half of 2001;
- Form an evaluation committee consisting of four insurance regulators, three insurer representatives and a consumer advocate by July 1, 2001 so that an effective evaluation of the limited launch can begin; and
- If the limited launch is successful, role out CARFRA on a nationwide basis within one year of its inception.

The Improvements to State-Based Systems Working Group has the following short-term goals:

- Implement the common filing transmittal forms in all states by the September 2001;
- Publish the state review standards checklists for all states and all lines of insurance by September 2001;
- Encourage states that have the ability to modify regulatory requirements toward more market-based regulation to do so as soon as practical;
- Encourage states that require legislation to change the regulatory framework for commercial lines coverage to prepare the needed legislation for the next available session;
- Complete its deliberations on the appropriate regulatory framework for personal lines coverages by the end of 2001;
- Provide its recommendations for amendments to the NAIC's Property and Casualty Insurance Rate and Policy Form Model Law by September, 2001 and present the recommended language to the NAIC's Property and Casualty Insurance Committee at the NAIC's Fall National Meeting

Need for Uniformity Among Insurance Products

One of the principle reasons that the regulation of insurance has traditionally been left for the states is because there are many differences that are not, and never will be, best served by uniform national insurance products. A property insurance policyholder in Florida is worried about damage from hurricanes and houses falling into sinkholes in addition to fire and theft. Those in the state of Michigan are still waiting for their first hurricane, but we face some nasty winter storms and are worried when tornado warnings are given. For those who live in California, we would add earthquakes and tsunamis to their list of concerns. The workers' compensation laws in each state are different. If Congress chooses to move toward uniformity, it would also be attacking the basic legal framework and all of the related case law in the states. In Michigan, the auto reparation system provides unlimited medical benefits in a no-fault environment while her neighboring state of Ohio relies completely on the tort system to compensate its auto accident victims. Therefore, it is questionable as to whether many property and casualty insurance products are not good candidates for uniformity unless a lot of other changes are also made.

The states have recognized that some insurance products are good candidates for uniformity and have taken steps to address those. The CARFRA project provides the state-based solution for insurance products where national uniformity is possible or desirable. It has an interesting side benefit of pointing out in a very clear fashion where state differences occur. It is a good vehicle for a state legislature to see where their state is out of step with the rest of the nation. Once national standards have been developed and agreed upon, states enter the deviations from the national standards into the system so any variance is obvious to public policymakers. This two-pronged approach will allow everyone to opt for the system that they believe benefits their organization best, while recognizing that some insurance products may be impossible or impractical to make uniform.

Successful Speed to Market Effort on Behalf of Banks Selling Insurance Products

At the NAIC's recent Summer National Meeting its Functional Regulation Working Group addressed an issue that had been raised by banking interests. The four federal banking regulatory agencies were required to promulgate consumer protection regulations regarding the sale of insurance products in a depository institution. These requirements were spelled out in Section 305 of the Gramm-Leach-Bliley Act (GLBA). Some banking interests approached Illinois Director Nathaniel Shapo, chair of the Functional Regulation Working Group, and asked if he would consider developing an expedited approval process for insurer applications that are changed only to add the Section 305 disclosure language. They observed that the most efficient way to get these required disclosures before consumers was to include them in insurance application forms. Director Shapo agreed to pursue the request. He presented a proposal that contains a model bulletin and an expedited transmittal form to the working group. The working group promptly acted upon the request. Each state is designating a point person to receive and be sure that these amended application forms receive expedited treatment. This is strong evidence that the functional regulation envisioned in the GLBA is working well. This example of state regulators working with their federal counterparts to solve a speed to market problem bodes well for the future of these valuable relationships.

Conclusion

In summary, the speed to market effort, through its dual track, has developed two separate recommendations that, taken together, will greatly improve the timeliness and quality of product filing and review processes. The limited launch of CARFRA will allow a single point of filing with coordinated regulatory review based upon an agreed upon set of national product standards for certain products. The recommendations for improvements to state-based systems will streamline the way in which individual states handle product filings for the benefit of both insurers and consumers. States are committed to making both of these processes work well to benefit insurance consumers and insurers.

State of Ohio
Department of Insurance
2100 Stella Court Columbus, Ohio 43215-1067
(614) 644-2658 www.state.oh.us/ins

Bob Taft
Governor

J. Lee Covington II
Director

July 23, 2001

The Honorable Richard H. Baker
Chairman
Financial Services Committee, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Cannon House Office Building, Room 341
Washington, D.C. 20515

Re: Hearing on June 21, 2001, regarding Insurance Product Approval: The Need for Modernization -- Correction of Record Regarding Ohio's Product Regulatory Review Timeframe

Dear Chairman Baker:

Thank you for the opportunity to testify before the Financial Services Committee, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises on June 21, 2001, regarding the National Association of insurance Commissioners' (NAIC) Speed to Market Initiatives. I am writing to correct information provided to the Subcommittee by another witness regarding the time period for introduction of new insurance products in the state of Ohio.

To correct the record, I am providing the following information contained in reports prepared by the Ohio Department of Insurance reflecting the average regulatory review timeframes for property and casualty products and rates filed with the Department over the last 3 years.

Year	Review Timeframe	Improvement
1998	36.5 days	
		8.0 days
1999	28.5 days	
		5.6 days
2000	22.9 days	
		8.4 days
2001 (to date)	14.5 days	
Total Improvement: 1998-2001		22.0 days

With regard to life, health, and annuity product form filings, over the past ten (10) years, the regulatory review timeframe has averaged 19-days for health products, 16-days for life insurance products, and 19-days for annuity products. Health insurance rate filings, over the past ten (10) years, have averaged 21 days for review.

During the hearing, a study prepared by Professor Richard J. Butler, Department of Economics, Brigham Young University, was discussed. The Subcommittee was provided information from the study indicating that Ohio ranks 19th in the country for the Average Days Delayed, with an average days delay equaling 80-days. Based on the information from the reports of the Ohio Department of Insurance discussed above, the Butler study does not accurately reflect the regulatory review timeframe in Ohio.

In fact, Professor Butler's study does not even measure the regulatory review timeframe, but rather, it measures the period of time only one insurer voluntarily took to launch a product in the Ohio market after filing with the Department. The delay in Professor's Butler's paper is defined as the time between the date the company filed the product and the date the company began using the product.

Although most property and casualty products may be used as soon as they are filed with the Ohio Department of Insurance, many companies do not implement their programs at that time. For a variety of reasons, such as system programming, marketing plan development, and underwriter and agent training, companies delay the date for the product roll-out. This delay is beyond the regulator's control in Ohio. The accurate measure of regulatory delay is the time from delivery of the filing to final regulatory action - a statistic we call review timeframe. The measure used by Professor Butler, the number of days from filing with the state regulator to company implementation of the program, can significantly differ from the regulatory review timeframe.

At the Ohio Department of Insurance, we continually look for ways to improve the efficiency of our processes. Ohio is a pilot state for the Coordinated Advertising, Rate, and Form Review Authority (CARFRA). For property and casualty products, the chart above shows the dramatic improvements we have made over the past three years. These improvements are due to implementation of a new electronic filing system, a regulatory procedures review initiative, removal of prior approval system for most lines of insurance, and adoption of the NAIC's Speed to Market -- Improvements to State Based Systems Initiatives.

Because of our competitive market and regulatory environment, Ohio enjoys the 15th best personal automobile rates in the country and the best rates of any state with large urban markets. Further, Ohio ranks 2nd in the country for homeowners. These rates are even better than Illinois, a state touted by many in the industry for its regulatory system, which ranks 27th for personal automobile rates and 19th for homeowners. When comparing the average Ohio automobile and homeowners rates to the national average for automobile and homeowners rates, Ohio citizens enjoy approximately $300-$400 savings on insurance rates every year.

Thank you again for the opportunity to correct the hearing record regarding Ohio's insurance regulatory review timeframe. As I indicated during my testimony, I remain very optimistic that state Insurance Commissioners will be successful in our Speed to Market Initiatives, and that insurers and consumers will benefit from a streamlined insurance product review process. If I can assist you or the Committee in any way in the future, please feel free to contact me at (614) 644-2651, or e-mail me at Lee.Covington@ins.state.oh.us.

With best regards,

J. Lee Covington II
Director

cc: The Honorable Michael Oxley, Chairman, Financial Services Committee
The Honorable Bob Ney, Financial Services Committee
The Honorable Steven LaTourette, Financial Services Committee
The Honorable Pat Tiberi, Financial Services Committee
The Honorable Stephanie Tubbs-Jones, Financial Services Committee

TESTIMONY OF ILLINOIS STATE REPRESENTATIVE TERRY PARKE, PRESIDENT OF

THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL)

BEFORE THE U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT

SPONSORED ENTERPRISES OF THE FINANCIAL SERVICES COMMITTEE,

RAYBURN HOUSE OFFICE BUILDING, WASHINGTON, DC

JUNE 21, 2001

Chairman Baker, Members of the Subcommittee, my name is Terry Parke. Let me first express my thanks for the opportunity to speak to you today.

It is my privilege to represent the 100,000 residents of Schaumburg and Elk Grove in the Northwest suburbs of Chicago in the Illinois House of Representatives.

It is also my privilege to serve as President of the National Conference of Insurance Legislators (NCOIL). It is in that capacity that I appear before you today. NCOIL is an organization of state legislators whose primary area of public policy concern is insurance and insurance regulation. NCOIL legislators chair or are members of the committees responsible for insurance in their legislative houses across the country.

Since its inception more than 30 years ago, NCOIL has supported state regulation of the business of insurance as authorized by Congress in McCarran-Ferguson.

The states have established a strong record under that authorization. Insurance markets have grown and become increasingly competitive in terms of price and products. There are more than 3,300 property and casualty insurance companies and over 1,800 life and health insurance companies now in competition for customers in U.S. insurance markets. There are more than 760,000 insurance agents and brokers actively and directly engaged in the business. No other regulated private sector industry, in the U.S. or anywhere, offers such a competitive environment.

NCOIL legislators are ready to do what it takes to build on that record.

NCOIL recognizes that there is no escape from the fact that powerful technological and competitive forces challenge the state-by-state system of insurance regulation. NCOIL supports the efforts of the National Association of Insurance Commissioners (NAIC) to bring about needed efficiencies in the state-based system. NCOIL supports the NAIC Statement of Intent of March 2000, which outlined a plan for the future of insurance regulation under the Gramm-Leach-Bliley Act of 1999.

That statement and NAIC efforts since then have addressed, among other things, the need to speed and synergize the state-by-state process of policy form and rate approvals -- the need for "speed-to-market." That is the worthy focus of this hearing.

The NAIC has conceived and put into motion a voluntary plan to facilitate one-stop shopping for price and product approvals. The NAIC has initiated a trial run or "limited launch" of the plan, known as the Coordinated Advertising Rate & Form Review Authority, or CARFRA, in ten states.

That plan has promise. Its success is possible. It deserves every reasonable chance.

But, if necessary, NCOIL could support efforts to take this laudable NAIC effort one important step further. That step would overcome the fact that CARFRA is voluntary; that its opinions are advisory; and that it allows individual states to retain their own authority.

NCOIL could support efforts aimed at a totally independent national, state-based regulatory facility. Its purpose could be to decide on policy form and rate approvals.

Such an entity would

- have absolute authority,
- take its authority directly and totally from state governments,
- have its own exclusive appeal process,
- be totally free-standing, and
- be totally state-based and state-funded.

Its strength would lie in its power to make fast, effective and final decisions.

Its strength would lie in its keeping the regulation of insurance under direct state control.

Its success would lie in its capacity to speed products to world as well as Main Street markets.

Its success may require amendment of state rating laws.

Its success, we recognize, may require some ceding of state authority, possibly through an interstate compact or other means.

NCOIL has long advocated interstate compacts. But your Subcommittee, Congress, and all interested parties should view a compact not as an end in itself, but rather as a tool to achieve a greater goal.

That, of course, would not be the only option.

Among other options would be to let the market prove itself as a regulator. Any such move would, of course, require the presence of adequate solvency safeguards to protect against any self-destructive or overly competitive behavior. It would also require aggressive policing of the insurance marketplace with adequate punishment of any abusive sales and claims-paying practices.

A market approach can work. I am proud to say that Illinois has put its faith in the market since 1971. Illinois consumers have benefited from overall premium rate levels that are below most other states with high population and heavy traffic. Auto insurance is readily available in the private market in Chicago. The residual market is small. Nationwide surveys indicate that the percentage of uninsured motorists is below the average of other populous states. Other studies show that more auto and homeowners insurers are competing for business in Illinois. Illinois has more than double the number of competing insurers than states like Massachusetts and New Jersey, states that have price controls.

States have begun moving toward a market solution. NCOIL adopted a commercial lines deregulation model act in 1999. Since 1995, 22 states have instituted some form of commercial lines rate and form filing deregulation.

Less than one month from now NCOIL will consider a comprehensive deregulation bill that would establish a competitive use and file system in states that adopt the measure. It would cover personal as well as commercial lines. Consideration of the proposed model follows an NCOIL hearing held on March 1 of this year. At the hearing, insurance industry witnesses argued that personal lines rate and form regulation is costly and inefficient. They argued for a substantial overhaul.

Solvency safeguards are already up and running and they have been for some time. State adoption of NAIC model uniform laws aimed at monitoring the financial strength and claims-paying ability of insurers through an NAIC accreditation program greatly reinforced and improved upon those safeguards. The fact of it is that for more than a century, the record of state insurance regulation compares most favorably with that of the regulation of other financial service institutions.

Significant steps toward improved regulation in the insurance marketplace have begun. NCOIL commissioned a study which identified areas where states need to improve the market conduct examination process. Based on the findings of that study, NCOIL is monitoring the progress of the NAIC today in the coordination of multi-state market conduct examinations, the training of market conduct examiners, and the validity of self-policing. NCOIL will mark progress in that regard when the Insurance Legislators Foundation, a research and educational arm of NCOIL, holds a public hearing in Chicago on July 12.

We will be happy to provide this Subcommittee with the transcript of that hearing.

It is not insignificant to note that Illinois introduced market conduct examinations in 1970 in tandem with its move to competitive regulation. In Illinois, market conduct examinations evaluate underwriting, advertising, agency operations, marketing, and claims practices. Those examinations measure the actual performance of insurers and their personnel against the provisions contained in the insurance policy contracts they have with their customers.

NCOIL believes that state regulation has served the needs of the families and businesses that buy insurance and has fostered a strong market of financially sound competitive insurers. Now NCOIL recognizes the need to respond to new challenges and modernize state-based insurance regulation. NCOIL is more than willing to work with all interested parties to make that happen.

Thank you. I would be happy to answer your questions.

A·C·L·I AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

Statement of the
American Council of Life Insurers

before the

Subcommittee on Capital Markets, Insurance &
Government Sponsored Enterprises
of the
House Financial Services Committee

On

Insurance Product Approval: The Need for Modernization

June 21, 2001

Statement Delivered By:
William B. Fisher
Vice President & Associate General Counsel
Massachusetts Mutual Life Insurance Company

1001 PENNSYLVANIA AVENUE, N.W., WASHINGTON, D.C. 20004-2599
(202)624-2000 FACSIMILE: (202)624-2319

Statement of William B. Fisher
on behalf of
The American Council of Life Insurers

Mr. Chairman and members of the Subcommittee, I am William B. Fisher, Vice President and Associate General Counsel for Massachusetts Mutual Life Insurance Company based in Springfield, Massachusetts ("MassMutual"). MassMutual is the parent company of a global financial services organization that operates under the marketing name, the MassMutual Financial Group. The member companies of the MassMutual Financial Group, which include OppenheimerFunds, Inc., have $213 billion of assets under management as of December 31, 2000, and offer life insurance, annuities, disability income insurance, long term care insurance, retirement planning products, trust services, money management and other financial services and products.

I am appearing today on behalf of the American Council of Life Insurers. The ACLI is the principal trade association for life insurance companies, and its 426 member companies account for over 80% of the life insurance in force in the United States.

Within the ACLI, I co-chair the Policy Advisory Group that has developed the industry's agenda for modernizing the regulation of life insurance companies and their producers. I appreciate the opportunity to appear this afternoon and present the views of life insurance companies on the issue of "speed-to-market" and its competitive implications for our business.

Improving the efficiency of life insurance regulation has unquestionably become one of the most important matters confronting our business. I think it is fair to say that the CEOs of many of the ACLI's member companies view it as nothing short of a survival issue in the current competitive environment. As a consequence, regulatory reform has been made a top priority at ACLI.

Competitive Implications: Speed-to-Market Versus Functional Regulation

At the outset, it should be understood that the competitive considerations associated with speed-to-market are distinctly different from those that were at issue in the context of the Gramm-Leach-Bliley Act. In GLB, we sought statutory certainty that when commercial banks or others were engaged in the business of insurance, their activities would be governed by the same laws and regulations applicable to traditional insurance companies and agents. The requirements of functional regulation mandated by GLB assured a high degree of competitive equality – but only in the context of firms or individuals engaging in the business of insurance.

Speed-to-market connotes a very different, external competitive consideration that reflects the new marketplace environment in which life insurers increasingly find themselves. Historically, life insurers competed only against other life insurers. Whatever the inefficiencies of multi-jurisdiction insurance regulation, companies incurred them equally. Things have changed radically in recent years. Financial services integration and modernization is occurring at a breakneck pace throughout the insurance and financial services sector. Life insurers, as providers of life insurance, annuities, and other financial security and retirement security products, must compete directly with non-insurance financial institutions such as banks and mutual funds. These firms enjoy regulatory efficiencies that translate into significant marketplace advantages.

The ability of our competitors in other industries to introduce new products nationally in a very short timeframe and to have any requisite regulatory approvals handled just once rather than 50-plus times are now critical considerations for life insurance companies. Therefore, insurers increasingly judge the effectiveness of their own system of regulation by comparing it with the regulatory systems of their non-insurance competitors.

In the context of this new competitive environment, life insurers' inability to bring new products to market in a timely and efficient manner is one of the most serious shortcomings of the current regulatory system. In the age of the Internet, when consumers expect to be able to consider many sophisticated financial products rapidly, the insurance industry will be left behind by its major competitors as a result of its current regulatory environment.

The competitive inequality is amply demonstrated by the time it takes to bring a product to market on a nationwide basis. Life insurance products typically are subject to state-by-state prior approval by state insurance regulators, a process that can take anywhere from six months to as much as two years to complete. In addition to being long, the product approval process also involves application of differing state laws and, even where the laws are uniform, widely divergent state standards, interpretations, and requirements applicable to identical products. For a company such as MassMutual, the result is unnecessary dedication of resources and lost opportunities.

For our individual life insurance products, it takes approximately four weeks for an experienced person working full time to put together a single product filing in all states. This is exclusive of the product development time and the time spent in responding to regulators' comments and questions. We also preliminarily estimate that last year alone, we lost at least $50 million in sales (measured by premium) due to the inability to get products to market more quickly.

In contrast, national banks do not need explicit regulatory approval to bring most new products to market on a nationwide basis, and can be in the marketplace in a matter of weeks. Securities firms typically get regulatory approval for new products in three to four months from a single regulator.

As a result of the slow pace with which insurance companies can get products to market, consumers select other financial service providers to meet their planning needs. According to an ACLI-sponsored study entitled *Monitoring of Public Attitudes 2000*, "Banks are consumers' top choices for a wide array of financial services (47%) and on par with stock brokerages in using up-to-date technology (36% vs. 35%)." On the other hand, consumers view life insurers "at the bottom in both categories, at 5 percent and 4 percent, respectively."

As a result, organizations with both insurance and non-insurance operations are being forced to allocate capital away from their insurance operations in response to the inefficiency of the insurance regulatory system. Over the long run, the implications for insurers and their customers of these adverse capital allocation decisions are serious, and they can be expected to worsen as consolidation and cross-industry diversification continue in the post-GLB environment.

Consumers also suffer from the inability of life insurers to bring their products to market quickly, because product approval delay often translates into consumers' inability to obtain the best price or most favorable product features a company can offer. The life insurance marketplace is highly competitive in terms of both price and product features, as illustrated by the increasingly shorter life cycles of insurance products. When I joined MassMutual in 1971, it was not uncommon for our products to be on the market for eight years or more before they required replacement or significant modification. Today, the life cycles are substantially shorter, due primarily to the need to remain competitive on price and product features, as well as the need to comply with new regulatory requirements, such as the new reserve regulation for term insurance and the development by the National Association of Insurance Commissioners ("NAIC") of new mortality tables. For example, the life cycle for our variable life and universal life insurance products is approximately two years; for term insurance, approximately one year; and for disability income insurance, approximately two to four years.

Although regulatory efficiency is clearly a key issue of concern to the entire insurance industry, I should note that the ACLI is not speaking on behalf of the property and casualty insurance industry. Since the property and casualty insurance products are generally not in direct competition with bank and mutual fund products, the property and casualty industry's concerns about speed to market may well differ from those of life insurers.

ACLI Study of Insurance Regulation

Within the ACLI membership, CEO concerns over time delays and other regulatory inefficiencies grew so serious that the association's Board of Directors concluded that it was imperative that we address the issue of regulatory reform as aggressively as possible. The first step in this process involved a comprehensive study of the current state of life insurance regulation that was undertaken in 1998 and completed in late 1999. The objective of the study was to pinpoint those aspects of regulation that were working well and those that were hindering insurers' ability to compete effectively and thus in need of improvement. The following was the principal conclusion reached in this study:

> While laws and regulations governing life insurers are generally viewed as necessary and appropriate, they are seldom uniform from state to state and, even where generally uniform, frequently subject to divergent applications and interpretations from one state to another. These factors lead directly to concerns over unnecessary regulatory costs and, even more importantly, concerns over matters of timing (e.g., product approvals or licensing of agents and companies). Life insurers believe that competitors in the securities and banking industries are increasingly able to act in a more timely and efficient manner as they serve the needs of consumers of financial products and services. Even the short-term implications of this situation are viewed as extremely serious.

This study has served as the blueprint for the ACLI's regulatory reform efforts. In addition to identifying speed-to-market as an increasingly critical factor in our ability to operate effectively, the study established the principle, which is noted in the above excerpt, that life insurers are not using regulatory reform as a means of escaping appropriate regulatory requirements, be they oriented toward solvency protection or consumer protection. To the contrary, life insurers are seeking a strong system of regulation – but one that operates on a much more efficient basis.

CEO Survey

The ACLI's efforts to modernize the life insurance regulatory system have from the outset been led by chief executive officers of its member companies. These executives have set the association's agenda, orchestrated its activities, and established its priorities. As the ACLI completed its study of regulation, these CEOs concluded they should prioritize the shortcomings identified in the study for two reasons: first, to explain more precisely to our state regulators which concerns are the most pressing from our perspective, thereby enabling the states to better set their own agenda for change; and second, to assist the ACLI in evaluating its own options for change.

The ACLI surveyed all its member company CEOs in 2000 to identify their most prominent concerns about the current regulatory system. The most significant conclusion derived from this survey was that policy form/contract approval (speed-to-market) is far and away the one element of insurance regulation

CEOs believe is most in need of reform. An executive summary of the CEO survey is appended to this statement.

Examples of Speed-to-Market Difficulties

In order to more fully appreciate the severe practical and competitive implications of speed-to-market limitations, the following MassMutual examples illustrate the types of difficulties life insurers encounter on a daily basis.

MassMutual Financial Group offers a fairly typical individual universal life insurance product. Of the 52 jurisdictions in which we do business, only eleven have accepted our "standard" version; 41 jurisdictions have special requirements that result in our having a separate version for each of those jurisdictions. While the variations range from a total repricing of the product to reasonably minor wording changes, nevertheless the result is the need for a separate version for virtually every state.

Even where the laws are relatively uniform, we have encountered interpretive issues that are as problematic as statutory differences. For example, MassMutual is currently seeking approval of its latest generation disability income insurance product. Since we began issuing disability income insurance in 1965, we have routinely included a provision permitting us to require proof of continued disability after a claim is initially approved. Many disabilities are not permanent and last for short durations; the purpose of the provision is to counter fraud and permit the insurer to identify claims where the disability has ended. One state is currently refusing to approve this provision on the basis that it would constitute an unfair claim practice and result in harassment of the insured. Even if we are successful in convincing the policy form reviewer that there is no legal or public policy basis for the department's position, resolving the problem takes time and delays the availability of the product to consumers in that state.

Solutions

In June of 2000, the ACLI Board of Directors put in place a policy position on regulatory reform establishing a two-track approach for dealing with the issue. Under the first track, the ACLI committed to redouble its efforts to work with the NAIC and individual states to improve our state-based system of life insurance regulation. Under the second, the ACLI was directed to draft legislation providing for an optional federal charter for life insurers. Both tracks were given equally high priority.

Summary of ACLI Report on Optimal-Product Regulation Approach

In November 2000, the ACLI prepared a report, which was made available to the NAIC, that contains recommendations for improving the uniformity, efficiency, and timeliness of regulatory review of policy forms. These recommendations form the conceptual foundation for our suggested improvements to a state-based system of insurance regulation and for the product approval process incorporated in our working draft of optional federal charter legislation (albeit with different implementation considerations). The following discussion is limited to our recommendations vis-à-vis state insurance regulation and the NAIC's response.

Based upon its review and analysis of the problems with the current system of product regulation, the ACLI report, entitled "An Optimal Approach to Insurance Product Regulation," proposes a regulatory structure for insurance products that protects consumers while allowing ACLI member companies to bring their insurance and annuity products to market with the speed and efficiency enjoyed by non-insurance competitors in the financial services marketplace. The report observes that, in order for insurers to remain competitive in the future, philosophic and systemic modifications to the structure and process of insurance product regulation are needed.

The ACLI believes that moving products to market more quickly and effectively enhances consumers' ability to plan for their insurance and retirement needs. Accordingly, the report recommends that a single point for insurance product filing be established, where much of the product-based regulatory review is shifted to a "back end" review of product compliance and administration in the marketplace, rather than the current "front end" prior review and approval of products. Insurance and annuity products that meet established national standards should be filed with a single entity acting on behalf of insurance regulators for informational purposes only, with no prior approval required, before they are marketed and sold.

The proposed optimal structure developed in the report is summarized below:

1. A single entity would be established with sole jurisdiction over products.
2. National standards for the product lines marketed by ACLI members would be identified.
3. Companies would certify that they meet the national standards before issuing a product (except for certain types of products that are entered into with sophisticated clients).
4. No prior approval would be required for most products.
5. If national standards for a particular product are unclear, the company could seek an interpretive ruling from the single entity regarding the product's compliance with applicable national standards.

6. Products would be filed with the single entity for dissemination to the states through an electronic means.

7. Products could be monitored through a back end system of review through the market conduct examination process. However, the single entity would be the arbiter/interpreter of a product's compliance with the national standards.

The ACLI report acknowledges that substantial time and effort will be necessary to fully develop this recommendation and implement it at the state level. This should be viewed as a long-term solution (over several years), rather than one that could be implemented quickly.

NAIC Response to Date (CARFRA)

The NAIC has launched a pilot project involving 10 states that seeks a centralized, coordinated review and approval process for policy forms, named "The Coordinated Advertising, Rate and Form Review Authority" or "CARFRA." CARFRA currently provides insurers with a single point of filing for 3 product lines (individual term life, individual flexible premium deferred annuities, and Medicare Supplement) for the 10 states. National standards for these products are identified, as well as individual state deviations to those standards. Companies must use a specific electronic filing repository established by the NAIC ("SERFF") to file a product, and the CARFRA regulators, who have pooled their resources and formed expert teams to review the filings, have guaranteed a response to a filing within 45 days. The "limited launch" of CARFRA began on May 1, 2001. Other states and other products are expected to be added to CARFRA later this year.

Industry View of CARFRA

The ACLI commends the NAIC and the regulators' efforts to craft an interim measure designed to achieve a single point of filing and uniform standards. While CARFRA in its initial phase does not achieve many of the objectives set forth in the ACLI report, it is recognized that state regulators must operate within the constraints of the existing legal structure, where deviations in product content and filing processes exist state by state. The ACLI believes that CARFRA is a good "first step" toward the realization of a broader solution, and is working closely with the NAIC to implement CARFRA.

Practical Considerations

The achievement of a single point of filing with national product standards within the existing state regulatory system is a challenging task. The fact that 10 states have agreed to national standards for 3 product lines, as well as a process for jointly reviewing a product filing within 45 days, is encouraging. However, there are a number of practical considerations that will need to be worked through in order to realize this goal.

First, the states' laws and rules governing product content are by no means uniform. This problem is evident in reviewing the "deviations" to the national standards reported by the 10 CARFRA states. While several states have reported no deviations or only a few deviations for each product line (Alabama, Arkansas, Ohio), others have identified 8 to 20 deviations (Oregon, Pennsylvania, Texas). The State of New York has over 140 reported deviations to both the life insurance and the annuity product. Accordingly, companies must alter their product filings for CARFRA based on the deviations identified by each state. Until the states adopt uniform product standards for the many lines of insurance sold today, as well as interpret them uniformly, national product standards are impossible to achieve.

Second, state membership in CARFRA is voluntary. States may be unwilling or unable to cede sufficient authority to a separate body to approve a product for sale in their respective states. Even when a state is a CARFRA member, this difficulty is also apparent in the CARFRA process. A recommendation whether to approve a product is an "advisory" recommendation only. Member states retain the ability to make a separate decision regarding a filing. In addition, states must also review the product separately if they have identified any "deviations" to the national product standards. This sovereignty issue could impede states from establishing a single review process that is efficient and meaningful.

Thus, while the NAIC has produced a significant accomplishment with CARFRA, the establishment of national product standards and a single review process for the lines of business marketed by ACLI members in all fifty states is, at best, very challenging. Whether the state system of insurance regulation can meet this challenge remains to be seen.

Conclusion

Insurance constitutes a vital component of the financial services industry and the overall U.S. economy, providing innumerable retirement security products and services to consumers all across the country. It is imperative, however, that insurance regulation be modernized and made more efficient as the competitive landscape of the 21st century evolves. The current framework is unacceptable, and that fact is widely acknowledged today by regulators and regulated alike.

In sum, the financial services marketplace has changed very dramatically in the past several years, and our system of insurance regulation has not kept pace. Immediate and substantial reform is necessary to assure the short and long-term well-being of our business.

AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

CEO SURVEY ON REGULATORY REFORM PRIORITIES

Executive Summary

February 2, 2000

1001 PENNSYLVANIA AVENUE, N.W., WASHINGTON, D.C. 20004-2599
(202) 624-2000 FACSIMILE (202) 624-2139 www.acli.com

CEO SURVEY ON REGULATORY REFORM PRIORITIES

Executive Summary

Overview

Following the publication of the Report on Regulatory Efficiency and Modernization, ACLI surveyed its member company CEOs for the purpose of identifying their most prominent concerns about the current regulatory system. The survey assessed CEO reaction to the 18 elements of state regulation scored in the ACLI Report as unsatisfactory or in need of improvement. CEOs were then asked to provide three different types of data on these elements:

- Ratings of each element as a "critical problem," major problem," "minor problem," or "not an issue."
- Selection of the five elements they felt should be ACLI's top priorities for regulatory reform.
- Selection of the one element that they felt is the most critical problem faced by the industry.

Surveys were mailed to a total of 436 CEOs. There were 194 surveys returned for a response rate of 44%, relatively high compared with other similar studies.

Conclusions

1. Policy form/contract approval is clearly the one element of regulation that CEOs believe is in most need of regulatory reform.

2. Although the level of concern regarding any other element does not come close to that of policy form/contract approval, CEOs do identify others as well. Over half of the CEOs find agent appointments, agent licensing, replacements, reserving and valuation actuary opinion, market conduct examination, company licensing/charter authority, advertising, state taxation of life insurance companies, and statutory accounting to be critical or major problems.

3. All elements relating to authority to do business are subject to some concern or are fairly high priority among CEOs. Elements relating to financial regulation, on average, have the lowest level of concern.

Findings

CEOs were far more apt to rate policy form/contract approval as an element that presents a critical problem than they were any other element. Nearly two-thirds (63%) of CEOs rated this element as a critical problem, compared to 28 percent who gave this rating to agent appointments, 26 percent who gave this rating to agent licensing and 15 percent who gave this rating to company licensing/charter authority. No more than fifteen percent found any other element to present a critical problem to the industry. Over nine-in-ten (91%) found policy form/contract approval to be at least a major problem facing the industry. (Figure 1)

While a majority of CEOs did not find elements other than policy form/contract approval to be critical problems, for eight of the remaining 17 elements, half or more found them to present at least a major problem to the industry. Combining "critical problem" and "major problem" ratings, these included: agent appointments (70%), agent licensing (69%), reserving and valuation actuary opinion (58%), market conduct examination (57%), replacements (54%), company licensing/charter authority (53%), advertising (53%), and state taxation of life insurance companies (51%).

Although sample sizes are small, large companies (83%) were more apt than medium size companies (61%) or small companies (58%) to find policy form/contract approval to be a critical problem for the industry. They were also more likely to find agent appointments, agent licensing, market conduct and replacements to be critical problems than were medium or small companies. (Table 1)

By asking CEOs to check off their top five priorities for regulatory reform, the second survey question ensured that a number of the 18 elements would get selected. However, despite this question format, a much higher percentage of CEOs (81%) checked off policy form/contract approval than any other element. The elements garnering the next highest percentage of checks were agent licensing (55%), agent appointments (49%) and market conduct examinations (42%). Following at some distance behind these were advertising (31%), reserving/valuation actuary opinion (28%), replacements (28%), state taxation of life insurance companies (28%), and company licensing/charter (27%). Remaining elements were considered one of the top five priorities by less than one-quarter of CEOs. (Figure 2)

There was little difference in the percentage of CEOs from large (86%) companies, medium (86%) and small (79%) companies who felt that policy form/contract approval was one of the top five priorities for regulatory reform. CEOs from large companies were somewhat more apt to find agent licensing, agent appointments, market conduct examination and advertising to be high priorities than were CEOs from smaller companies and less apt to find audited statutory financial statements to be a priority. Smaller company CEOs were somewhat more likely than others to find company licensing/charter and state taxation of life insurance companies to be high priority areas, and less likely to feel this way about nonforfeiture. Again, these findings are based on small sample sizes. (Table 2)

Finally, when asked to rank the problem they thought was most critical to the industry, over four in ten (44%) CEOs picked policy form/contract approval – close to five times as many as selected any other category. Less than 10 percent selected any other category, although 21 percent did not answer the question. (Figure 3)

When examining all of the elements, those within the broad area of financial regulation tend to engender the lowest level of concern to CEOs. All of the elements within the area of authority to do business are subject to some concern, and as is clear from earlier discussion, the highest level of concern is regarding policy form/contract approval which falls within the product regulation category.

Figure 1
Elements of State Regulation Which Are Problems for Companies

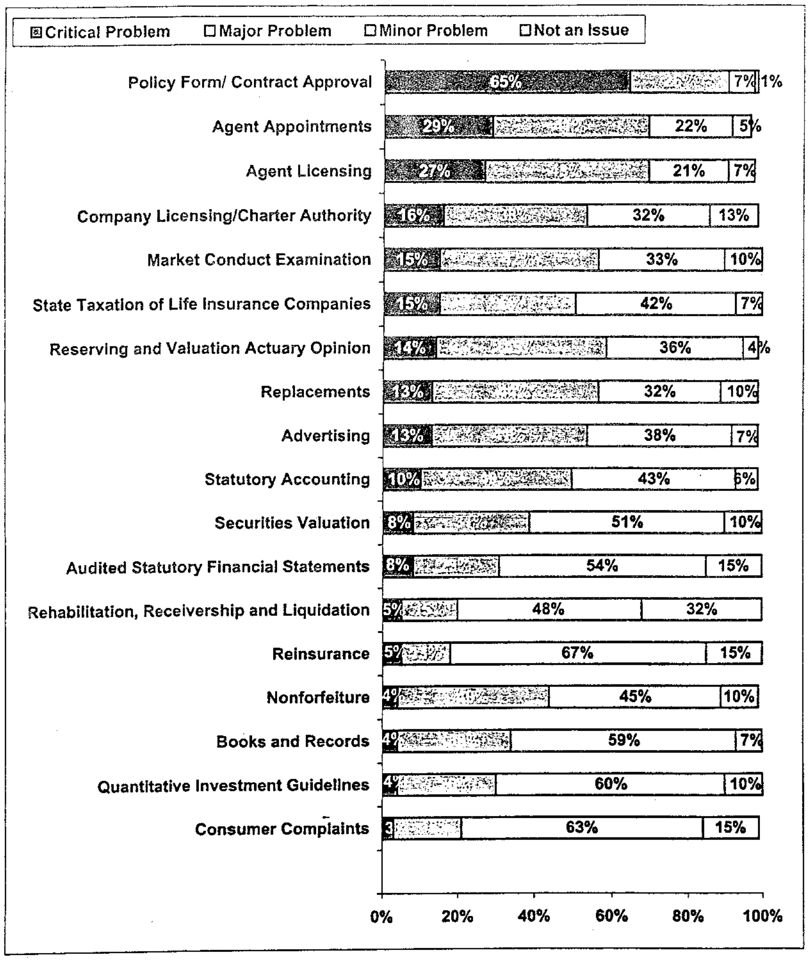


Table 1
Critical Concerns by Company Size

	Percentage with Critical Rating by Company Size			
	Total (n=168) %	Large (n=30) %	Medium (n=33) %	Small (n=105) %
Policy form/contract approval	65	83	64	61
Agent appointments	29	40	30	26
Agent licensing	27	47	27	21
Company licensing/ charter authority	16	13	12	18
Market conduct examination	15	23	12	13
State taxation of life insurance companies	15	13	12	16
Reserving/ valuation actuary opinion	14	10	6	18
Replacements	13	20	9	11
Advertising	13	13	12	13
Statutory accounting	10	10	12	9
Securities valuation	8	10	3	9
Audited statutory financial statements	8	3	12	8
Rehabilitation, receivership, liquidation	5	3	3	6
Reinsurance	5	--	6	6
Quantitative investment guidelines	4	3	9	3
Nonforfeiture	4	3	6	4
Books and records	4	3	3	5
Consumer complaints	3	--	6	3

Figure 2
Top Priorities for Reform

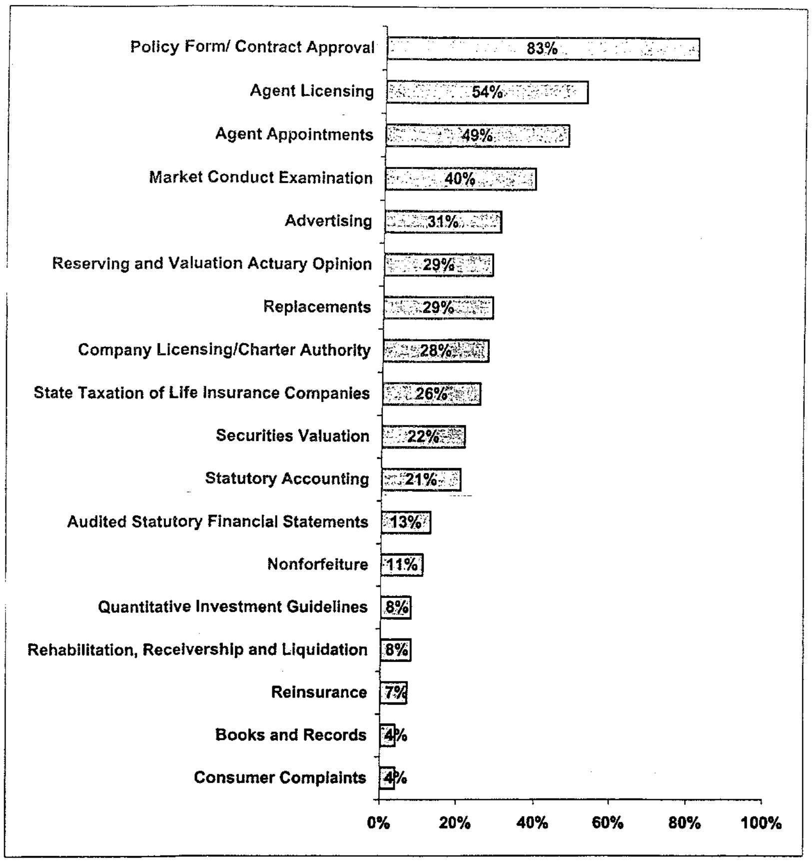
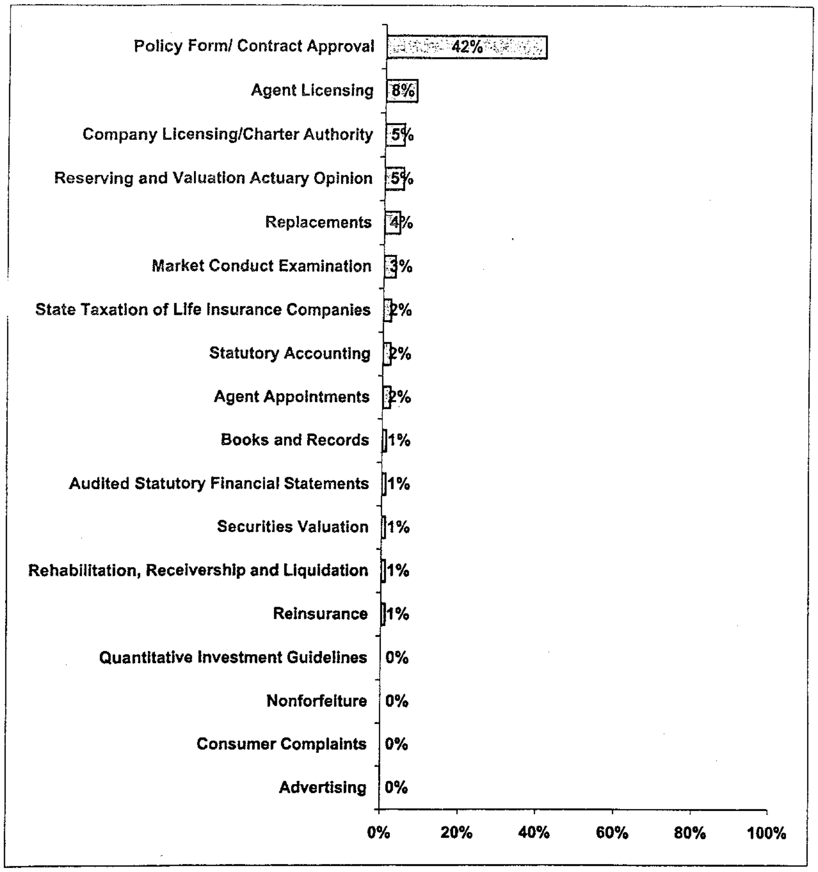


Table 2
Top Priorities for Reform by Company Size

	Percentage Checking Category as One of Five Top Priorities for Reform by Company Size			
	Total (n=168) %	Large (n=30) %	Medium (n=33) %	Small (n=105) %
Policy form/contract approval	83	87	85	81
Agent licensing	54	63	55	50
Agent appointments	49	57	45	48
Market conduct examination	40	53	42	35
Advertising	31	43	27	29
Replacements	29	40	39	22
Reserving/ valuation actuary opinion	29	30	21	30
Company licensing/ charter authority	28	20	15	34
State taxation of life insurance companies	26	20	12	32
Securities valuation	22	27	18	22
Statutory accounting	21	20	15	23
Audited statutory financial statements	13	3	15	15
Nonforfeiture	11	20	18	7
Quantitative investment guidelines	8	3	21	6
Rehabilitation, receivership, liquidation	8	3	9	9
Reinsurance	7	--	9	8
Consumer complaints	4	--	9	4
Books and records	4	--	6	5

Figure 3
The Most Critical Problem Faced by the Life Insurance Industry



FINAL REPORT OF THE ACLI TASK FORCE ON PRODUCT REGULATION

EXECUTIVE SUMMARY

Background

The ACLI Task Force on Product Regulation was created in February 2000 and charged with developing recommendations to improve the uniformity, efficiency, and timeliness of regulatory review of policy forms. Based upon its review and analysis of the problems with the current system of product regulation, the Task Force's goal was the development of an optimal regulatory structure for insurance products which would protect consumers while allowing ACLI member companies to bring their insurance and annuity products to market with the speed and efficiency enjoyed by other competitors in the financial services marketplace.

After review and discussion of the current product regulatory environment for other financial services products as well as similar systems in other countries, the Task Force determined that there was no existing model for product regulation that would meet the ACLI's ultimate goal. The Task Force concluded that, in order for insurers to remain competitive in the future, philosophic and systemic modifications to the structure and process of insurance product regulation would be needed.

In devising a comprehensive overhaul of the current process of product regulation, the Task Force approached its work on a dual track – that is, to flesh out the details of an optimal concept, as well as address how that concept could be implemented in the existing state-based regulatory system. Further, the Task Force responded to various NAIC proposals for reform of this process. A large number of ACLI member company representatives devoted many hours of research and discussion throughout the year in order to accomplish these tasks.

Recommendations for an Optimal Product Regulatory Structure

The Task Force believes that moving products to market more quickly and effectively would enhance consumers' ability to plan for their insurance and retirement needs. Accordingly, the Task Force recommends that a single point for insurance product filing ("SPOF") be established, where much of the product-based regulatory review is shifted to a "back end" review of product compliance and administration in the marketplace, rather than the current "front end" prior review of products. Insurance and annuity products that meet established national standards should be filed with a single entity acting on behalf of insurance regulators for informational purposes only, with no prior approval required, before they are marketed and sold.

The proposed optimal structure is summarized below:

1. A single entity would be established with sole jurisdiction over products.

2. National standards for the product lines marketed by ACLI members would be identified.

3. Companies would certify that they meet the national standards before issuing a product (except for certain types of products that are entered into with sophisticated clients).

4. No prior approval would be required for most products.

5. If national standards for a particular product are unclear, the company could seek an interpretive ruling from the single entity regarding the product's compliance with applicable national standards.

6. Products would be filed with the single entity for dissemination to the states through an electronic means.

7. Products could be monitored through a back end system of review through the market conduct examination process. However, the single entity would be the arbiter/interpreter of a product's compliance with the national standards.

While the Task Force report provides a detailed description of this optimal approach to product regulation, members recognize that more time and effort will be necessary to fully develop the recommendation and implement it. This should be viewed as a long-term solution (over several years), rather than one that could be implemented quickly.

Next Steps – Working With State Regulators and Legislators

At the time of this writing, the NAIC has proposed a centralized, coordinated review process, entitled "CARFRA". We would emphasize that the focus of this report is the ACLI's concept of an optimal structure for product regulation, and is not intended to be a detailed response to the CARFRA proposal, which is still evolving. Rather, the optimal approach outlined in this report may serve as a baseline for evaluating short- and long-term proposals for modernizing our current product regulation system.

The ACLI commends the members of the NAIC Speed to Market Working Group and their efforts to craft an interim measure designed to achieve a single point of filing and uniform standards. While CARFRA in its initial phase does not achieve many of the objectives set forth in this report, we recognize that regulators must operate within the constraints of the existing legal structure, where deviations in product content and filing processes exist state by state. The ACLI believes that CARFRA is a good "first step" toward realization of a broader solution.

The ACLI looks forward to working with regulators, legislators, consumers, and other insurers in implementing product regulation reform. We hope that the research and discussion contained in this report are useful in developing a shared vision for how to achieve the objectives described herein.

Executive Summary

Regulatory Efficiency and Modernization

An Assessment of Current State & Federal Regulation of Life Insurance Companies and an Analysis of Options for Improvement

As it has done at various times over the years, the ACLI commenced a review in late-1998 of the current system of state and federal regulation of life insurance companies. The review pinpoints those aspects of the regulatory system that are working well and identifies those aspects that are hindering life insurers' ability to compete effectively and best meet consumers' needs in today's rapidly changing financial services marketplace. Based on this review, four options for improving the life insurance regulatory system were initially identified, and the following three remain under active consideration:

- building greater efficiencies into the present state-based system of regulation;
- implementing uniform national standards in select areas where the greatest need for uniformity of regulation exists; and
- providing for an optional federal charter for life insurance companies.

Each option carries with it practical and political advantages and disadvantages. No effort was made in this analysis to favor one option over another. Importantly, under each of these options, state regulation of the business of insurance would remain a vital and integral part of the insurance regulatory landscape. Under each, the ACLI would remain committed to making state regulation of insurance operate more efficiently.

Concerns with the present regulatory system are not intended to suggest that life insurers are seeking to diminish or escape regulatory obligations. Indeed, this report acknowledges the appropriateness of most of the elements of regulation. Rather, the report suggests that the ability of regulators to administer important consumer protections and financial safeguards in a uniform and efficient manner should be the foundation upon which a modern system of life insurance regulation should be based.

The ACLI report is designed to stimulate dialogue among our member companies, regulators, legislators, consumers and others on how best to improve and modernize our regulatory system. Our business is undergoing changes that are more rapid and profound than at any other time in our history, and it is imperative that our system of regulation keep pace. We hope the report will serve as a catalyst for greater efficiencies in regulation that ultimately will benefit insurers, their customers and those regulating our business.

This review was initiated at the request of the ACLI Board of Directors. It is an educational tool and does not constitute any change in ACLI policy or reflect any consensus view of the ACLI, its Board of Directors, or its membership regarding how increased regulatory efficiency should be accomplished.

American Insurance Association

TESTIMONY
OF
ROBERT C. GOWDY
CEO OF BEACONONE INSURANCE GROUP

ON BEHALF OF
THE AMERICAN INSURANCE ASSOCIATION

ON INSURANCE PRODUCT APPROVAL THE NEED FOR MODERNIZATION

BEFORE THE
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT-SPONSORED ENTERPRISES
U.S. HOUSE OF REPRESENTATIVES

JUNE 21, 2001

American Insurance Association

Thank you Mr. Chairman, my name is Robert Gowdy, and I am the President and CEO of OneBeacon Insurance Group located in Boston, Massachusetts. I am here today on behalf of the American Insurance Association, which represents over 370 major property-casualty insurers. Before I begin, I would like to thank you for the opportunity to testify before this panel.

Over the past two decades, most sectors of the financial services industry have undergone regulatory reform to facilitate speed to market for the innovative new products that have reshaped our financial landscape. Regulatory modernization also has accelerated competition among financial firms, thus reducing prices while expanding options, service, and quality for consumers. Against the backdrop of increasing reliance on marketplace dynamics, the property/casualty insurance industry stands out as one of the most heavily regulated sectors of our economy with respect to both price and product controls—commonly referred to in the insurance context as rate and form regulation.

Speed to market reform will benefit the insurance mechanism as a whole and, in particular, the individuals, families, and businesses who rely on property/casualty insurance products for short- and long-term financial security. AIA has been working closely with the National Association of Insurance Commissioners ("NAIC"), and individual state legislators and regulators, to promote speed to market in individual state systems. We commend the Subcommittee's focus on this topic as part of your broader examination of insurance regulation in the post-Gramm-Leach-Bliley era.

Compelling Forces At Work In the U.S. and Global Economy

The insurance regulatory system that is now in place is largely the result of the McCarran-Ferguson Act, enacted in 1945. In the last fifty years, and most dramatically in the last decade, the entire U.S. economy has undergone radical restructuring. Yet, the insurance regulatory system is largely unchanged. For the past twenty years, the NAIC and individual state regulators have debated insurance regulatory reform. NAIC reports have been written, model laws have been approved and amended, and incremental improvements have been made in a number of states. But, these changes are not enough to propel the insurance regulatory system into the 21st century. Indeed, a number of recent developments have accelerated the need for significant regulatory reform to facilitate speed to market for property-casualty insurance:

1130 Connecticut Avenue, NW, Suite 1000 ▼ Washington, DC 20036 ▼ Phone: 202/828-7100 ▼ Fax: 202/293-1219 ▼ www.aiadc.org

- ***Financial Services Modernization:*** Improved technology, the internet, global trends, and the 1999 passage of the Gramm-Leach-Bliley Act will bring companies and products offered by the banking, securities, and insurance industries closer together, while at the same time increasing competition among these industries. Excessive levels of regulation place property-casualty insurance at a competitive disadvantage compared to banking and securities, industries that operate with a minimum of price and product regulation, particularly as financial institutions, and financial products, converge under Gramm-Leach-Bliley.

- ***The Global Economy:*** Modern telecommunications, ease of travel, the internet, and liberalization of trade have made insurance and financial service markets truly global. This trend will only accelerate. An important strategic issue for the competitiveness of the U.S. in world trade is that a number of leading nations, particularly members of the European Union and Canada, have comprehensively deregulated their insurance markets. Viewed against the backdrop of freer insurance markets abroad, U.S. property-casualty insurers are often severely restrained in their ability to innovate and quickly adapt to changing consumer interests and economic trends. In addition, while working to open up opportunities for American insurers abroad, state regulators, trade negotiators, and policymakers need to be aware of how complex and over-regulated the U.S. insurance market appears to foreign insurers hoping to do business here. To serve as an example for further liberalization of regulatory systems abroad, the U.S. needs to free its own insurance markets from unnecessary and counter-productive regulation.

- ***The Internet and E-Commerce:*** The internet is helping to expand the amount of information available to consumers about insurance beyond resources available just a few years ago. An increasing number of property-casualty insurers are building web sites to deliver quotes and planning a major push to market insurance over the internet. There also are several comprehensive insurance web sites that allow consumers to shop and receive quotes from dozens of companies in one location. On the regulatory front, the NAIC is working to improve the ability of consumers to navigate its own web site, as well as developing "best practices" for state insurance departments to use in enhancing their own web sites. The availability of education, information, and shopping opportunities through the internet will allow insurance markets to work better than ever before, thus further obviating the need for restrictive rate and form regulation.

  The technological revolution also has created the need for new risk management products for business and personal use. While these products can be developed by insurers at "Internet speed," the regulatory approvals needed to bring a product to market often operate at the speed of an ancient mainframe.

When Insurers Are Allowed to Compete Aggressively, Consumers Benefit

While pervasive rate and form regulation characterize the insurance regulatory environment in most states, a few jurisdictions have adopted a market-based approach, with very positive results, including more market insurers competing for business and, all other factors (e.g., traffic density, claiming behavior, attorney involvement) being equal, lower insurance prices. A recent study by University of South Carolina Professor Scott Harrington classified the states into three basic groups—(1) states with little or no price regulation, (2) states with moderate price regulation, and (3) states with very stringent price regulation.[1] Summarizing the results of this study:

- Fourteen states with competitive or minimal pricing oversight had the lowest annual auto insurance prices, averaging $585.

- Ten states with a medium level of price regulation averaged $648 annually.

- The twenty-seven states with very stringent price controls were the most expensive states for auto insurance consumers, with annual expenditures averaging $695. This came to $110, or 19%, higher on an annual basis than the 14 states with minimal or no price regulations. The states with stringent price controls include several that long have had among the most expensive auto insurance costs in the nation—New Jersey, Hawaii, Rhode Island, Massachusetts and Delaware.

- Furthermore, states with competitive rating systems attracted more insurers into the market, creating more competition and choice for consumers. By contrast, numerous insurers have withdrawn from the

[1] Harrington, Scott, "*Insurance Deregulation and the Public Interest*," AEI-Brookings Joint Center for Regulatory Studies, January 2000. In the study, University of South Carolina's Professor Harrington divided the 50 states and Washington D.C. into the three categories of no prior approval, (14 states), conditional prior approval, (10 states), and prior approval of rates required (27 states) and calculates average auto insurance premiums for 1996 for the three groups. Note: Washington D.C., which was one of the 27 counted as having strict prior approval has moved toward a more competitive rating system, and is considering further deregulation. Early results from deregulation of auto insurance rates in Washington D.C. as of year end 1999, indicated several new carriers entering the market, an 84 percent decline in the number of policies written by the residual market from 1997 to 1999, and a decrease in auto insurance premiums.

heavily regulated markets in Massachusetts and New Jersey, despite significant exit barriers that have been imposed by those states.

Specific Examples of Consumer Benefits From Regulatory Reform

Illinois has had a competitive rating law since 1978, one that does not require any sort of rate review or approval from the state. It is one of the best examples of consumer benefits flowing from rate reform. Illinois has a large urban population, typically one factor leading to higher auto insurance prices due to higher traffic density. Because of population and traffic density, the presence of a large metropolis, and other factors affecting losses, Illinois would normally be expected to rank among the top 10 states for auto insurance costs. However, Illinois perennially ranks in the middle (24th-26th) among states for auto insurance prices, and competition has been a key factor. There are significantly more auto insurers competing in Illinois than similar urbanized states such as New Jersey or Massachusetts that have implemented strict price controls.

South Carolina is a more recent example of the benefits of regulatory reform for consumers. In a well-intentioned, yet flawed effort to make insurance more affordable for low to moderate income drivers and reduce uninsured motorists, South Carolina adopted restrictive rate regulation in 1974, coupled with creation of a "reinsurance facility" to insure riskier drivers. The market became so over-regulated that, by the mid-1990s, the reinsurance facility insured over 40% of South Carolina drivers, meaning that four in ten auto insurance consumers were unable to select their insurer of choice. Losses were high, and most insurers were operating at a loss, causing a number of companies to exit the South Carolina market. Rates began to increase significantly due to the burden of the reinsurance facility. In 1997, legislation was passed to deregulate the market and phase out the reinsurance facility. The results have already been dramatic for consumers—the number of insurers doing business in the state doubled over a one-year period, and good drivers generally have seen rate decreases of 20% or more.

On the business side of insurance, Michigan is a positive example of the benefits of deregulation. A number of years ago, Michigan deregulated pricing and form regulation for commercial lines insurance policies (e.g., commercial auto, commercial multiperil, liability, property, umbrella, and other specific policies). This allows commercial insurers to bring new products serving the Michigan economy to the marketplace much sooner than is the case in most other states. Each year the Michigan Insurance Department does a study of the commercial insurance market as a precaution to assure that the market is fully competitive with regard to products available, numbers of competitors, and pricing. There have been no reported problems with commercial insurance markets in Michigan, and each year the market is declared fully competitive using traditional economic measures.

Problems Associated with Restrictive Regimes

In a study presented earlier this year at an AEI/Brookings symposium on insurance regulation, Professor Scott Harrington conducted an econometric analysis of the impact of rate regulation on auto insurance consumers and insurers during the quarter century spanning 1972-98.[2] His findings further discredit the merits of restrictive rate regulation. Specifically, Professor Harrington found that prior approval rate regulation was strongly associated with reduced coverage availability and increased volatility for both insurers and consumers. Insurers saw more volatility in loss experience, while consumers saw more volatility in pricing because insurers were unable to process small increments of either price increases or decreases based on loss experience. When rate adjustments finally were approved by prior approval states, they were significantly larger than in states with less rate regulation, bringing 'sticker shock' to consumers.

Professor Harrington also found that prior approval regulation is "persistently and reliably associated" with larger residual markets (i.e., state-created facilities that provide insurance for individuals or businesses which no private insurer is willing to underwrite because the regulated price is inadequate given the risk involved). Residual markets are supposed to be markets of last resort for very high risk drivers, businesses, and properties. A large residual market means that average and sometimes even good risks are perceived as high risk given the premium that insurers are permitted to charge in a restrictive rate regulatory environment. Most insurance consumers prefer being served by a private company and its representatives. Consumers placed in a residual insurance market have few, if any, pricing or product options and no competitors vying for their business. Claim and other services are often provided by a vendor who has no vested interest in the customer.

In addition, rate regulatory restrictions often force some policyholders (e.g., safer drivers or employers, or homeowners who live away from coastal hurricane zones) to subsidize others who pose more risk to the system as a whole. By encouraging riskier activities, such subsidies drive up total system costs and may result in an unfair redistribution of income.

On the product side, one of the most significant indirect costs of insurance rate and form regulation is the excessive time delay that insurers experience in trying to gain approvals for new products in 50 states. Time delay for product approvals varies tremendously by state. A few states (e.g., Michigan and Minnesota on commercial forms) essentially have no time delay because they allow free market forces and informed consumers to regulate the content, scope, and pricing of new products. However, in the other states, the average delays for all product filings exceed seven

[2] Harrington, Scott E., Professor, Darla Moore School of Business, University of South Carolina, "An Econometric Analysis of Insurance Rate Regulation," prepared for the AEI-Brookings Conference on Insurance Regulation, January 18, 2001.

months, with delays in some lines of insurance in a few states averaging close to a year. The variations in the amount of time it takes to launch a new product or change a rate in all 50 states adds additional complexity and costs. Because there is so much uncertainty and variation in the amount of time states take to process new products and rate changes, insurers rarely, if ever, can count on being able to launch new and innovative products in an orderly and planned fashion throughout the U.S. According to a study by Professor Richard Butler of Brigham Young University, the loss of consumer welfare due to lengthy delays in product approvals and launch, amounts to an average countrywide hidden tax for new products of about 9%.[3]

Moreover, business customers using alternative risk transfer markets (e.g. self-insurance, captive insurers, risk retention groups, etc.) do not have to deal with the complexities and delays of the varied multi-state approval system. In contrast, insurers operating in traditional markets are at a cost disadvantage and consumers lose out by having to pay higher prices and having fewer choices. According to Professor Butler, the shift from traditional commercial insurance to alternative markets over the last 20 years, caused in part by this hidden tax and dysfunctional form regulation, represents an annual loss of $18.6 billion in traditional commercial insurance premiums. Moreover, because a sizeable portion of the alternative risk market is offshore, economic output, jobs, and premium (as well as other) taxes are lost to the states and the U.S. Treasury.

SUMMARY

Comprehensive regulatory reform of property-casualty insurance will bring insurance consumers numerous benefits. Here are some examples, based on evidence from states that have substantially reformed their insurance regulatory systems:

- Consumers should realize savings in insurance costs as the market becomes more efficient, competitive, and the costs of unnecessary regulation are squeezed out of the system.
- Consumers are likely to have more product options, particularly with respect to innovative personal and commercial lines coverages.
- The availability of insurance also should increase in areas that sometimes experience shortages of carriers, including areas subject to natural disasters. Although prices may rise in such areas to adequately cover the true risk, product options like deductibles and discounts for loss mitigation also would increase.

[3] Butler, Richard J., Professor, Department of Economics Brigham Young University, "Form Regulation in Commercial Insurance," prepared for the AEI-Brookings Joint Conference on Insurance Regulation, January 18, 2001.

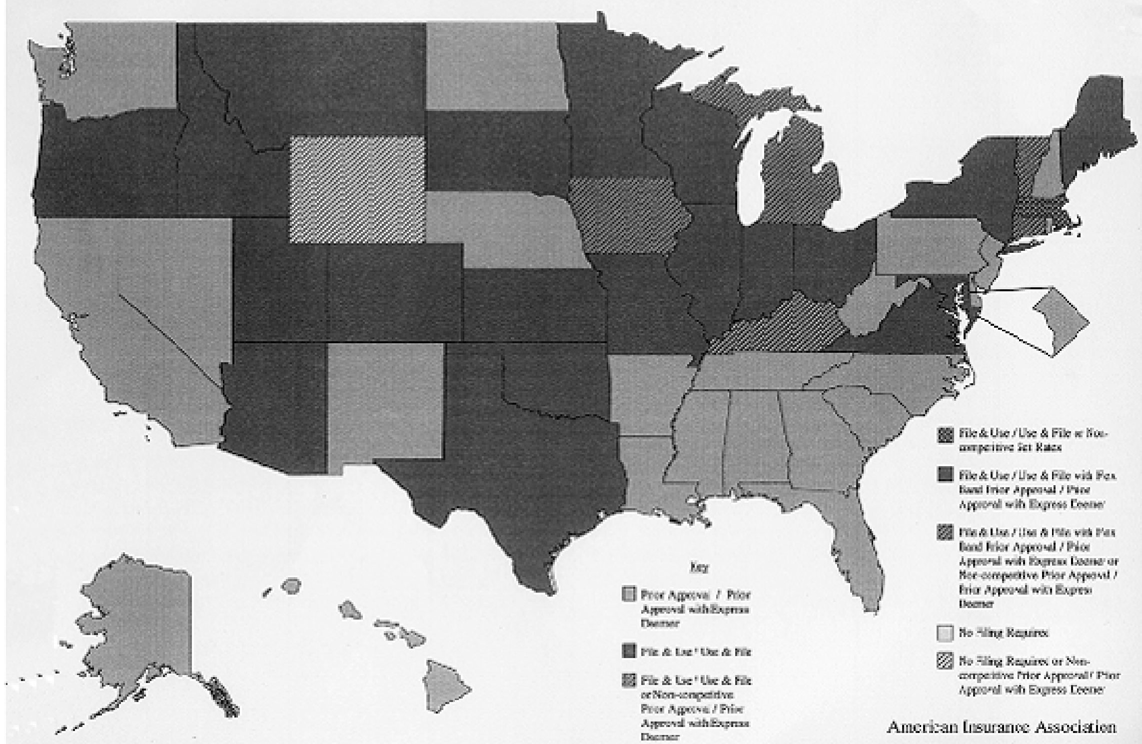
- Market-based systems will reduce subsidies that lower-risk consumers often provide to those with higher risk characteristics (e.g., development in hazardous areas, high risk drivers).

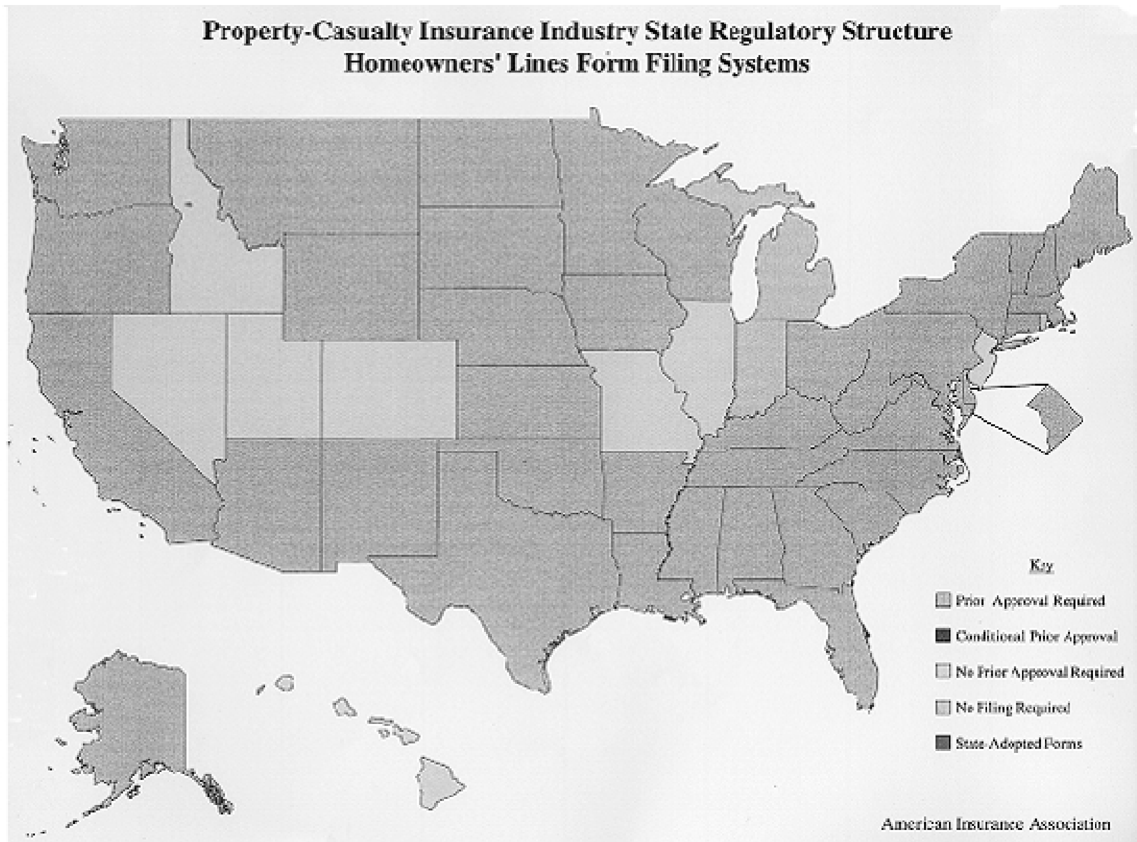
- Insurance markets will better keep up with fast-paced change in the economy and the financial needs of individuals, businesses and families.

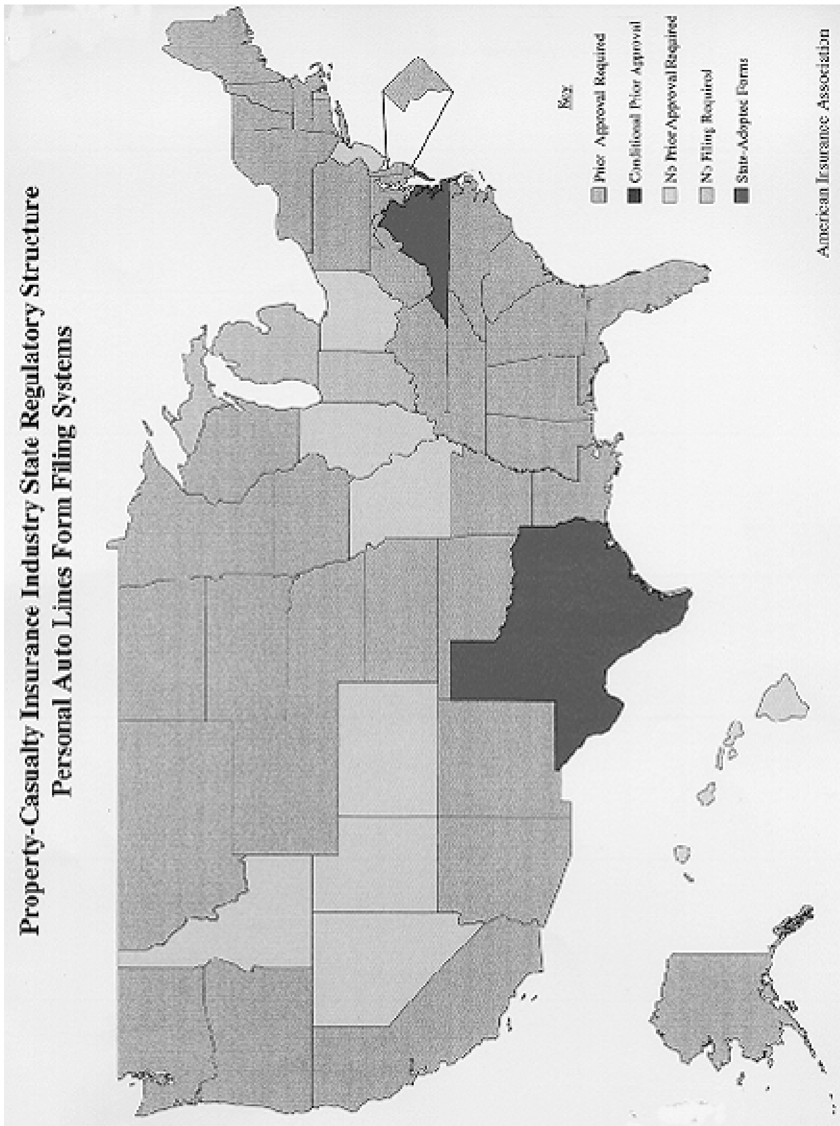
- Finally, insurance deregulation will benefit consumers, state insurance markets, the national economy, and taxpayers in a more general way by creating a more competitive insurance industry that can adequately service U.S. business and compete in a global economy.

Financial services, modernization, the global economy, foreign trade liberalization, E-Commerce, and better informed consumers are combining to create an urgent need for comprehensive insurance regulatory reform to assure a healthy, consumer-oriented U.S. property-casualty insurance industry for the 21st century. We appreciate the Subcommittee's attention to this important issue.

Property-Casualty Insurance Industry State Regulatory Structure
Personal Auto Lines Rate Filing Systems




Property-Casualty Insurance Industry State Regulatory Structure
Homeowners' Lines Form Filing Systems
Key
Prior Approval Required
Conditional Prior Approval
No Prior Approval Required
No Filing Required
State-Adopted Forms
American Insurance Association


Property-Casualty Insurance Industry State Regulatory Structure
Personal Auto Lines Form Filing Systems
Key
Prior Approval Required
Conditional Prior Approval
No Prior Approval Required
No Filing Required
State-Adopted Forms
American Insurance Association

TESTIMONY OF ALLIANCE OF AMERICAN INSURERS & NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

BEFORE
U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE and GOVERNMENT SPONSORED ENTERPRISES

JUNE 21, 2001

TESTIMONY BY ROBERT L. ZEMAN
VICE PRESIDENT AND ASSISTANT GENERAL COUNSEL
NATIONAL ASSOCIATION OF INDEPENDENT INSURERS
AND
RITA NOWAK, ASSISTANT VICE-PRESIDENT
ALLIANCE OF AMERICAN INSURERS

I am pleased to present the following statement on behalf of the Alliance of American Insurers (AAI) and the National Association of Independent Insurers (NAII). Together we represent over 1000 property/casualty insurance companies doing business across the United States. In terms of property/casualty insurance marketshare, collectively our members write 45 percent of the property/casualty market. We want to commend the members of the Subcommittee for holding this important hearing. During the next few minutes I will provide the Alliance and NAII's perspective on the critical issue of regulatory modernization and speed-to-market.

SPEED-TO-MARKET ISSUE

Support for the ability for insurers to compete in a competitive marketplace has been the hallmark of our respective organizations from their inception. We are hearing from our members, however, unprecedented levels of concern regarding the regulation of rates and forms in many states and how it is hurting competition. The reality is that insurance markets have evolved at a much faster pace than insurance regulation. There is significant diversity across the states on how property and casualty rates and forms are regulated. Also, different lines of business have varying levels of regulatory oversight in a given state. Personal and commercial lines rate and form regulatory laws in many jurisdictions have roots in the 1940s and are now grossly outdated. Many states still require prior approval of all changes in automobile insurance rates and forms. These "prior approval" requirements only serve to drain insurance department resources that could be better directed toward other activities such as solvency and market conduct. They add to the underlying costs of insurance, and stifle innovation.

Regulatory approaches taken by the states fall within the following spectrum of options:

- Prior Approval – Insurers must receive approval in advance before any changes in pricing or policy forms can be made.
- Flex Rating – Under this approach, companies can increase or decrease rates within a certain range without obtaining prior approval.
- File and Use – In these states, changes in rates and/or forms must be filed with the Insurance Department, which generally will have 30 days to review the filings before the given changes can be used.
- Use and File – Under this approach, product and pricing changes can be used immediately as long as they are filed with the Insurance Department. Most states taking this approach still allow the Insurance Department to check and measure these changes against applicable statutory and regulatory standards.
- Open Competition – In these states, either an informational filing or no filing is

required. (Illinois has successfully used this approach for decades for all lines of business, and several states use variations of the approach for larger commercial risks.)

It can be difficult to categorize a state due to differences in how individual lines of business are regulated. Generally speaking only about 15 states use a competitive approach in their laws governing personal lines rates. Restrictive laws and regulations are not the only barriers to bringing insurance products to market. Barriers also can take the form of problematic insurance department practices, creating a culture that limits innovation.

ASSOCIATION SURVEYS

Both of our organizations have conducted surveys of our members regarding speed-to-market in the states. Members were asked to identify the best and worst rate and/or form filing practices for both personal and commercial lines. We did indeed receive some positive feedback regarding certain states. Positive comments included timely review, fewer forms to complete, fewer layers in the process and clear instructions.

We also found confirmation of the frustration that our members feel regarding impediments to approval of rate and/or form filings in other states. Many states received at least one vote in terms of displaying a poor rate and/or form filing process characteristic. Respondents to our surveys cited the following as the most common examples of barriers to speed-to-market:

- Slow review, approval and acknowledgement of filings;
- Inadequate, inexperienced and/or non-supportive staff;
- Too many and too complicated forms;
- Burdensome requirements, rigid rules, multi-layered processes;
- Unwritten standards ("desk drawer" rules);
- Confusing or unclear instructions.

Beyond individual practices, our members commented that in some states the department culture or mindset toward excessive regulation impedes competition.

The number one problem identified by the members in the surveys was slow approval or even acknowledgement of filings. On a national commercial product rollout, generally, an insurer can expect that approximately twenty-six (26) states or jurisdictions will approve a commercial filing in less than 60 days; some may take less than thirty (30) days. Approximately, nineteen (19) states will approve the product within 90 days. The remaining six (6) states may take up to a year for approval.

Some of these hurdles can be at least partly ameliorated by implementing operational reforms at the insurance department level. Clearly, however, in many states there also is a need for a public policy change that would provide a more streamlined competitive environment, with regulator attention being more focused on solvency and market conduct issues rather than micro-management of individual insurer rates and forms.

In constructive fashion we are following up with insurance departments across the country to discuss the barriers to bringing new products to consumers. The purpose is to encourage each state regulator to implement as many operational reforms as possible in the short term. We also pledge our support and assistance toward working together with each regulator to win enactment of public policy changes in the legislature.

EXPERIENCE IN MORE COMPETITIVE STATES – BENEFITS FOR CONSUMERS

The survey results from our members reflect growing frustration over the fact that property casualty insurance in particular remains one of the most heavily regulated markets in the United States. Some states including but not limited to Illinois have more competitive oriented regulatory systems and the benefits for consumers as well as insurers are clear. There is a growing body of academic studies regarding prior approval versus more competitive regulatory rate laws and the benefits for consumers in states with competitive systems. Examples of some of the latest academic evidence indicates:

1. "There is little or no evidence that prior approval on average has a material effect on average rates. … Prior approval regulation is, however, reliably associated with lower availability of coverage. It is positively and significantly related to residual marketshares, even when states with reinsurance facilities or related residual market mechanisms and the largest residual marketshares are excluded from the comparison. Prior approval regulation also is reliably associated with greater volatility in loss ratios and expenditure growth rates after controlling for the influence of a number of other variables that could affect volatility." (*From An Econometric Analysis of Insurance Rate Regulation*, Scott Harrington)

2. "The Illinois experience suggests that rate regulation for automobile insurance is unnecessary. Illinois has functioned without a rating law since 1971. Auto insurance is widely available from a large number of competitors. Rate changes are frequent, modest and appear to follow claim experience. Loss ratios and the size of the uninsured and residual market are in line with that in states that have competitive rating laws. Thirty years of experience suggests that the automobile insurance market functions without regulation." (*Insurance Price Deregulation: The Illinois Experience*, by Steven D'Arcy)

3. "From the mid-seventies through 1998, South Carolina intensively regulated auto insurance. Rate levels and rate structures were restricted, insurers underwriting discretion was limited and large cross-subsidies were channeled through its residual market. Contrary to political expectations, but consistent with economic theory, these regulatory

> measures worsened market conditions. … South Carolina's prior approval system was replaced by flex rating and restrictions on risk-based pricing and underwriting were substantially eased. The Reinsurance Facility and its large subsidies are being phased out and replaced temporarily by a JUA and ultimately by an assigned risk plan that will be required to charge adequate rates. … With most of the reforms becoming effective in 1999, it is too soon to determine their ultimate outcome, but the early prognosis is positive. The number of insurers writing auto insurance has doubled with the implementation of the reforms. Many insurers have implemented more refined risk classification and pricing structures, as well as alternative policy options for consumers. It also appears that overall rate levels have continued to fall, possibly reflecting declining claims costs, as well as the easing of restrictions of risk-based pricing. Most importantly, the Facility is depopulating rapidly." (*Auto Insurance Reform: Salvation in South Carolina*, by Martin F. Grace et al)

The success of competitive rating is far from limited to Illinois. Other states such as Wisconsin have had more competitive systems for years and enjoyed the benefits of competition. More recently the benefits of competition have become clear through the experience under the reform of the South Carolina automobile insurance rating laws. The more competitive approach used in these and other states may not be fully appreciated because they have been quietly working.

Also, some states have taken specific positive action regarding reform of form filing requirements for certain risks. These include Arizona, Colorado, Michigan, and Minnesota.

Recently a consumer group issued a report extolling the alleged virtue of the prior approval system in California enacted as part of Proposition 103. We suggest that you not be misled because the real reason for the decline in rates in California was dramatic decrease in loss costs stemming from stricter enforcement of seatbelt laws, stronger drunk driving penalties, and the Supreme Court's decision eliminating third-party bad faith lawsuits. After Prop 103 was passed, bodily injury costs in California peaked in 1991 (according to *Trends in Auto Injury Claims* by the Insurance Research Council.) Academic experts including former Illinois Insurance Director Phil O'Connor have noted that consumers could have benefited even more from these reductions in underlying costs but for the prior approval system.

The clear vast majority of academic as well as empirical evidence supports competition and the benefits it can have for consumers, and the downsides of prior approval for consumers. As you can see, however, despite the existence of more competitive systems in some states there is clearly a need for multifaceted reform in many others in order to facilitate speed-to-market.

THE SOLUTION; PART ONE:

PUBLIC POLICY CHANGES – BALANCED COMPETITION FOR CONSUMERS

While our organizations support competition, we do not call for elimination of regulation. We suggest states adopt laws that rely upon competition among insurers to determine insurance rates but also provide for regulatory intervention and consumer protection if a market is considered not to be competitive. Specific features of this approach which have to be tailored on a state-by-state basis, include:

1. Competitive rating law (i.e. no filing for large commercial, use-and-file for personal lines.)
2. There would still be a prohibition on rates that are excessive inadequate or unfairly discriminatory.
3. A regulator could not consider a rate excessive in a competitive market.
4. If a market is found not competitive, insurers would then have to receive prior approval of rate changes.
5. Advisory organizations may collect basic data but are prohibited from recommending rates or engaging in anti-competitive behavior.
6. All insurers and advisory organizations must maintain adequate records that can be

examined for compliance with the Act.

7. We have also proposed a specific requirement that consumers be given access by Insurance Departments to helpful information on pricing and coverages.

On the issue of forms, our recommended model includes the insurer self-certification process which has been highly successful in Colorado. Insurers submit a certification to the Colorado Insurance Department, which has authority to check the forms at any given time as well as during market conduct exams.

This approach strikes a reasonable balance by providing a competitive system, but with appropriate consumer safeguards such as additional authority for the insurance regulator upon a finding that a particular insurance market is not competitive. This approach also has to be refined to fit the nuances of each state.

THE SOLUTION; PART TWO:

OPERATIONAL EFFICIENCIES

We wish to commend Ohio Insurance Director Covington and the activities of the NAIC Improvements To State-Based Systems Subgroup. That group in 2000 produced a number of practical and operational suggestions that, if adopted immediately by individual insurance departments, would to a certain extent help speed the process of product approval in the states. Those suggestions include elimination of desk-drawer rules, use of clear checklists regarding what must be in a filing, and specific timeframes for action by insurance departments on proposed rate and form changes.

In our discussions with states, we have seen that many states are beginning to move toward more efficient regulatory practices. Unfortunately, we must share one concern. While some changes are being made in some states on process and procedure, the need to deal with mindset and regulatory culture remains in several others. Changing this culture and mindset will take time.

It is up to individual state insurance departments to effectuate operational efficiencies. We hope that regulators will also work with state public policymakers, as we are, to ultimately effectuate the public policy changes needed to assure that consumers are not denied the benefits of more competitive environment.

EARLY SIGNS IN THE STATE LEGISLATURES

Though the number of states is small, in various jurisdictions across the country state legislatures have considered or are considering during these current 2001 legislative sessions the potential for enactment of more open competition laws. For example, in Connecticut and Rhode Island legislators considered but ultimately did not enact flex-rating. The same result occurred in Nevada, which also considered a flex-rating approach. Alaska and Missouri enacted more competitive provisions on commercial lines. The Louisiana Legislature is still in session, and that Legislature is considering watershed reform that would largely eliminate the current rating commission approach and implement a file-and-use alternative. Also, it is good to note that since 1997, 22 states have adopted provisions eliminating filing requirements for certain commercial risks. Recall as well that Illinois and other states have had positive reforms in place for some time, and South Carolina is the best recent (1999) example of the benefits of implementing a more competitive system.

LEGISLATIVE GROUPS

In addition to our activities surrounding the surveys, plus our activities in individual states, both of our organizations have worked closely with national legislative groups such as National Conference of Insurance Legislators (NCOIL), the American Legislative Exchange Council (ALEC) and the National Conference of State Legislatures (NCSL) in order to highlight the importance of improving regulation in terms of modernization and efficiency. We participated in NCOIL's extensive hearing in early March regarding personal lines modernization. That organization is considering a competitive model law similar to one already adopted by ALEC. More recently, we participated in a panel discussion before the NCSL, to highlight the importance of this issue and to provide our thoughts on state-based solutions.

Clearly, part of the solution can be found in the operational efficiencies recommended by the NAIC. There also must be public policy changes for personal as well as commercial lines that take more competitive approach.

CONCLUSION

The Alliance and NAII commend this Subcommittee for holding a hearing on this vitally important topic. The persistence of prior approval rate regulation in some lines and states has imposed barriers to speed-to-market, with very negative effects for consumers. We need continued and accelerated reform in states on two fronts: implementation by insurance departments of the operational efficiencies and adoption by state legislatures of more competitive laws.

There is clear academic and empirical evidence in support of the value of modernization for consumers, especially in terms of marketplace stability, lower residual market populations, enhanced availability, and more accurate cost-based pricing. The experience of our members in key states supports these very same conclusions.

Property/casualty insurance remains one of the most regulated markets in the United States. Regulation of property casualty insurance products in particular must be modernized to embrace the benefits of competition, albeit with balanced consumer protections. The model approach outlined above strikes the appropriate balance and we urge states to support it.

We see some signs of progress through:

1) Activities at NAIC on the modernization issue;
2) Adoption by some state insurance departments of the operational efficiencies recommended by NAIC;
3) Studies conducted by and/or model laws produced by state legislative organizations, such as NCOIL, NCSL, and ALEC;
4) Action in a limited number of state legislatures thus far.

Clearly, however, there is need for action on both the operational efficiencies and public policy changes in more states. The time has come for unprecedented and truly meaningful cooperative activity among the NAIC itself, individual regulators, and state legislators as well as industry and consumer representatives in order to accomplish the important goal of modernization, consistent with the vision of Gramm-Leach-Bliley.

H:L\Zeman\Speeches\ 06-21-01 Statement

BIOGRAPHY

ROBERT L. ZEMAN

Robert L. Zeman serves as vice president and assistant general counsel for the National Association of Independent Insurers (NAII). Mr. Zeman's responsibilities at the NAII include supervision of all state legislative and regulatory affairs as well as involvement in corporate, litigation and policy development matters. He attained both a B.A. in political science (Cum Laude, 1982) and a Juris Doctor degree (1985) from Loyola University of Chicago.

Mr. Zeman's areas of expertise include tort liability, automobile insurance and constitutional law and he has published several articles on these subjects. He serves as liaison between NAII and a number of legislative and regulatory groups including the National Association of Insurance Commissioners, the American Legislative Exchange Council, and the National Conference of Insurance Legislators. Mr. Zeman is the current chairman for NCOIL's Industry Education Council.

He has served as chairman of the American Bar Association's Public Regulation of Insurance Law Committee, and as a member of that organization's special standing Committee on Public Relations. He is also a member of the American Corporate Counsel Association, the International Association of Defense Counsel, and the American Society of Association Executives.

Rita Nowak
Assistant Vice President, Property/Casualty
Alliance of American Insurers

Rita Nowak is an Assistant Vice President in the Property/Casualty Department of the Alliance of American Insurers, a national trade association representing 326 property and casualty insurance companies, based in Downers Grove, Illinois.

Ms. Nowak's current responsibilities include reporting legislative and regulatory activities in 14 states. She also acts as committee secretary for the Alliance's Commercial Automobile/General Liability Insurance Committee. In addition, she is the Alliance's point person on legislative and/or regulatory issues impacting commercial lines specializing in deregulation.

Prior to joining the Alliance in 1998, Ms. Nowak worked for CNA Insurance Company for 18 years in various capacities pertaining to commercial lines product development and regulatory compliance. Her most recent position at CNA was Assistant Vice President, Commercial Lines Product Development. As such, she was responsible for compliance, the filing function, the development of new products, and the maintenance of both independent and advisory organization products.

She also spent five years at Zurich American Insurance, where her responsibilities included the training of underwriters and raters.

Ms. Nowak graduated from the University of Illinois with a Bachelor of Arts in sociology. She obtained her Masters of Business Administration from the Illinois Institute of Technology.

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 21, 2001

NAMIC

JAMES A. BLUM, CHAIRMAN AND PRESIDENT
BROTHERHOOD MUTUAL INSURANCE COMPANY

TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC)

REMARKS TO THE U.S. HOUSE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES.

Good afternoon, Mr. Chairman, and members of the U.S. House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises. My name is Jim Blum. I am Chairman and President of Brotherhood Mutual Insurance Company of Fort Wayne, Indiana. I have been with Brotherhood since 1967 and have served in numerous capacities, including being named President in 1995 and Chairman of the Board in 2000.

Brotherhood Mutual dates back to 1916, when Albert Neuenschwander enlisted the help of his pastor, the Rev. Aaron Souder, in organizing a mutual aid program to provide fire and windstorm protection for members of the Defenseless Mennonite Church (now known as the Evangelical Mennonite Church). One year later, the dream became a reality when their denomination formed the Brotherhood Aid Association of the Defenseless Mennonite Conference. They chose Galatians 6:2-*"Bear ye one another's burdens and so fulfill the law of Christ"*-as the verse capturing the spirit of the new association. This verse still appears on every Brotherhood Mutual policy.

Today, Brotherhood Mutual is one of the country's leading insurers of churches and related ministries. The company writes coverages in 30 states and annually produces more than $100 million in direct written premium.

Today, I am here in my capacity as Chairman of the National Association of Mutual Insurance Companies, or NAMIC, as we are known. NAMIC is a full-service national trade association with more than 1,200 member companies that underwrite 40 percent ($123.3 billion) of the property/casualty insurance premium in the United States. NAMIC's membership includes five of the 10 largest p/c carriers, every size regional and national p/c insurer and hundreds of farm mutual insurance companies.

Competition: The Ultimate Speed-to-Market Reform

Companies doing business across the country or in a single state need to be able to enter a new market or establish prices with a minimum of difficulty. Unfortunately, too many states continue to rely on protracted prior approval processes that obstruct, or effectively bar, the marketing of innovative products in a timely fashion.

This is a disadvantage to both insurers and consumers. Prior approval frequently takes months to secure, costing insurers valuable marketing opportunities and depriving consumers of the advantages of new and improved risk-sharing products. The length of the prior approval process also inhibits the ability of insurers to compete successfully with other, less regulated segments of the financial services industry.

A key recommendation in our regulatory efficiency report, *Accepting the Challenge: Redefining State Regulation Now,* released in April 2000, was that states consider loosening prior approval requirements. In July of last year, the NAMIC Board of Directors adopted as the association's official position an open competition model for commercial and personal lines of insurance such as the regulatory framework used in Illinois since the 1970s. Beyond state checklists, operational efficiencies and electronic filing capabilities, we believe it is the most effective public policy to achieve speed to market.

There is an emerging consensus to modernize commercial lines regulation. Markets are strong, consisting of large, well-informed corporate buyers and sellers. Smaller commercial customers are still subject to prior approval procedures in acknowledgement of a perceived lack of sophistication.

While NAMIC is pleased that some states have moved to modernize regulation for large companies, it is critical that corporate insurance buyers of all sizes be included as well. Smaller companies need the full gamut of insurance choices available to them to be competitive overall. Only when all commercial policyholders are included will the full benefits of an open market be realized.

The same argument holds true for personal lines modernization. In prior approval states, prices are controlled by insurance regulators, in theory, to keep insurance affordable and available to consumers. But, as I will discuss shortly, in states such as South Carolina and New Jersey, government-established prices have not reflected the potential cost of losses, thereby increasing the financial vulnerability of insurers and the choices available to the public.

The consequences to consumers of these public policies have been almost entirely negative. Residual markets increase as insurers reduce voluntary market sales, there are fewer new insurer-entrants to the market, services to policyholders are reduced, incentives for policyholders to control losses decline and companies affect an outright withdrawal from a market. The end result is that policies designed to serve consumers have precisely the opposite impact. Experience has shown competition to be the most effective regulator of insurance rates.

Illinois discontinued prior approval requirements 30 years ago and their rates are consistently below other states with similar demographics. Studies show that there is more competition among homeowners and automobile insurers in Illinois than in any other state despite the fact that Illinois is not the largest state in the nation. Perhaps the most telling statistic of all is that the number of drivers in the residual auto market is lower in Chicago than any urban area located in rate approval states.

Illinois legislators are evidently pleased with this public policy. No bill to re-establish prior approval of rates has ever received a majority vote in either chamber of the Illinois legislature. As Dr. Phillip O'Connor, former Illinois Director of Insurance has written in his report, *Modernizing Insurance Regulation: Tacking to the Winds of Change,*

> "The reality is that over three decades in Illinois, no serious and sustainable constituency has developed favoring any form or rate regulation legislation, let alone a return to prior approval. Illinois' elected policy makers have found little reason to consider a return to regulation."

South Carolina has also experienced notable success with modernization of rating laws as well. During the first half of the 1990s, an average of 59 insurers did business in South Carolina while other southeastern states averaged 197 insurers. After the South Carolina legislature modernized auto insurance rate making practices in 1997, South Carolinians benefited from the choices provided by almost twice as many insurers and by a dramatic drop in the size of the residual market.

To refute what I have said in favor of competition, some will refer you to what has been written about the California's celebrated passage in 1988 of Proposition 103, mandating a 20 percent rollback in automobile premiums and a prior approval system for rates after two generations of competitive pricing.

Auto insurance rates have fallen and complaint volume at the California Department of Insurance is low. But simply slashing prices one-fifth without employing methods to lower the cost of inevitable losses could only result in insurer instability as company losses outpaced their ability to recoup expenses.

Insurance premiums are driven by expected loss costs; and California, with its massive population and multiple urban areas, will always be a high potential loss state. Fortunately, California's Supreme Court acted two months before Prop 103 was passed to overrule adverse prior decisions that had led to dramatic increases in auto claim-related lawsuits during the 1980s.

In addition, new laws were enacted to mandate seat belt use and reduce fraud by permitting its prosecution as a felony. Also, voters approved a bar on uninsured pain and suffering damages, commonly known as No Pay/No Play.

Therefore, it was this series of explicit public policy choices-- by lawmakers, voters and the courts--not the institution of prior approval that has caused prices to go down in California. It has even been suggested that prices in California could be lower still were it not for a restrictive rate law that makes adjustments uncertain, keeping them unnaturally high.

For the other side of the coin, I encourage you to review the regulatory environment in New Jersey, where consumers pay the highest premiums for auto insurance in the nation. Like California, New Jersey is densely populated with large urban concentrations, two critical factors in an insurer's cost calculations.

But there are also many regulatory obstacles that drive up costs in New Jersey such as strict prior approval, mandatory coverage requirements, an excess profits law, territorial rate caps and barriers to exit.

In 1998, New Jersey enacted the Automobile Insurance Cost Reduction Act (AICRA) that required mandatory 15 percent rate decreases and reforms aimed at reducing costs to insurers, although none of these reforms were projected to reduce costs by 15 percent as well. Even so, many of the cost reduction measures have yet to be implemented. Coupled with the "take all comers" law, insurers with high costs may well have insufficient revenues from which to pay claims.

Pricing relief is generally not available in New Jersey. Prior approval is so strict that the rate approval process takes a year. Over the last two years, 29 of 32 rate filings were rejected; and the three approvals were for only a portion of the requested adjustment.

Six of the ten largest auto insurers do not do business in New Jersey. Only about 60 companies in all do write auto insurance in the state. Within the last two weeks, State Farm, the state's largest writer with over 800,000 automobile insureds, announced that the regulatory climate in New Jersey was forcing them to withdraw from the state.

Some time over the next few years, one out of every five auto insurance buyers in New Jersey will be placed with a new carrier. That will mean confusion for some. For many, it will mean higher rates immediately. With one fifth of the market up for grabs and one giant provider no longer in the picture, there will be even less incentive to lower rates, among those few companies left in the market. Under this scenario, some consumers may simply decide not to carry auto insurance at all. That will mean more uninsured motorists and higher costs for drivers involved in accidents with them.

This afternoon you will hear compelling economic evidence that property-casualty markets are structurally competitive and that there is no apparent benefit to companies or consumers to perpetuating a system where rates must be approved prior to their implementation. NAMIC endorses those findings.

Requiring insurance regulators to spend their time doing what the market does more efficiently hurts insurers and consumers. Prior approval can be burdensome to regulators. Insurance departments are inundated with hundreds of filings each week, all requiring the attention of an over-worked staff otherwise unable to help monitor the marketplace. Reform would free regulators to undertake serious efforts to keep markets open, competitive and safe.

Opening insurance markets to more competition from across the country will not be realized overnight. Much will have to be done before comprehensive modernization can be enacted. By necessity, speed to market modernization requires a new approach to protecting consumers.

If state legislators need to balance the granting of market competition for insurers with a guarantee for consumer protection, reforming the market conduct examination program along the lines suggested by NAMIC in our *"Market Conduct Regulation for a Competitive Environment"* public policy paper would achieve that public policy balance. The NAIC has already begun a review process in this regard.

NAMIC is enthusiastic about the review of personal lines regulation now underway by both the NAIC and NCOIL. This is consistent with our position for open competition

We are developing an initiative in conjunction with our trade colleagues and national state legislative organizations to implement rate reform language in state legislatures beginning next year.

NAMIC supports model legislation, to be adopted by each state, that would have the following characteristics:

1. The existence of a statewide, competitive market for all lines of insurance would be presumed as a matter of law. The burden of proving the contrary would rest with the party making the allegation that a market lacks competition.
2. In a competitive market, personal line filings would be made within 30 days of their effective date and could only be disapproved if they are inadequate or unfairly discriminatory.
3. No filing would be required for commercial lines in a competitive market.
4. In a noncompetitive market, filings must be made 30 days prior to their effective date and may only be disapproved if they are excessive, inadequate or unfairly discriminatory.
5. The determination that a market is noncompetitive may only be made after an administrative hearing and the burden of proof is on the party making the allegation that the market is noncompetitive.
6. A ruling that a market is noncompetitive must specifically state all bases supporting that conclusion and actions the commissioner will take to re-establish competition. The ruling is valid for one year and may only be renewed after hearing.
7. All rulings must be issued in the form of findings of fact and conclusions of law and may be challenged in a court of competent jurisdiction. Renewal rulings must follow the same format and must also set out the actions the commissioner took, why those actions failed and what further steps will be taken to correct the problem.
8. The commissioner has an affirmative duty to monitor competition in the markets and to protect competitive markets.

Enactment of statutes like this by the states would firmly establish competition rather than prior approval as the preferred public policy governing insurance in the United States. With adequate due process protections, it would provide insurers with the predictability that products would be allowed to come into the market more quickly, affording consumers more choices at lower prices.

The Nature of the Problem Facing American Insurers

Driving us to undertake this initiative is the frustrating and inconsistent regulatory procedures and requirements present in the current state system. A drafter's note in a proposed NAIC Property and Casualty Model Rating Law suggests that average approval processes last from 15 to 90 days. Anecdotal information suggests that this note is overly optimistic. One academic study has concluded that in states with the strictest regulatory approval process, entry to the market can take almost 90 percent longer than it does in states with fewer approval requirements. These delays limit product options and reduce competition, which ultimately hurts consumers.

Compliance alone is costly. The NAIC has found that companies spend $1 billion annually to keep up with commercial lines regulatory requirements. State governments spend another $40 to $55 million each year to process prior approval filings.

There are widespread industry complaints about the use of so-called "desk drawer" or "non-statutory" regulatory requirements. In other words, regulatory decisions based on "rules" with no basis in law.

A recent NAIC survey found that one state identified 33 filing requirements for commercial lines polices, eight of which were "unpublished." The NAIC recognizes this problem and has targeted it for reform in its Improvements to State-Based Systems Report.

Accountability for Speed to Market Reform

Holding the National Association of Insurance Commissioners (NAIC) solely accountable for enacting insurance regulatory reforms is not a realistic expectation.

Given the non-binding nature of the NAIC, I would submit that the more powerful players in any struggle for state regulatory modernization are the men and women who write the laws in the country's 50 state capitals and the District of Columbia. Or, to borrow an old saying, "The NAIC proposes but the legislature disposes."

The real potential for state reform can be measured by the will of state legislatures to act. Individual regulators clearly have a role to play in their states to raise the profile of and enlist support for these important market reform issues. In the final analysis, however, state legislative action should be the focal point of accountability for speed to market reform.

For state regulatory modernization to occur, a trusting partnership must be nurtured among regulators, legislators and the insurance industry to bring about comprehensive, fundamental reform in public policy. This is not a new concept.

As a result of several well-publicized insurance-company insolvencies in the late 1980s and the early 1990s—and concerns expressed by Congress that states were not adequately performing as regulators—the NAIC resolved to improve the state solvency surveillance regime.

NAIC created the accreditation process. It identified several key model bills that were seen as strengthening the financial oversight of companies. Perhaps foremost in this effort was the NAIC's Codification of Statutory Accounting Principles, which was directed at making uniform the states' patchwork of insurance accounting. Codification required legislatures, by act in every state, to delegate authority to prescribe insurance accounting procedures to the NAIC.

Working closely with state legislative organizations like the National Conference of Insurance Legislators (NCOIL), the NAIC was able to coordinate enactment of the necessary legislation for accreditation in nearly every state across the country. A renewal component was built into the accreditation and most states continue today to remain accredited by the process that the NAIC created.

A more recent example of a trusting partnership is the uniform producer licensing requirements mandated by the Gramm-Leach-Bliley Act (GLBA).

In its advisory role to the states, the NAIC brought together regulators and industry to craft a model act to fulfill the GLBA requirements for a more uniform producer licensing process across the country. During the past two legislative sessions, 35 of the 51 bills introduced in the states have been enacted and that number is expected to possibly reach 40 by the end of the year.

These two examples underscore the type of action that we all seek to achieve speed to market reform.

The NAMIC Board of Directors has committed fully the resources of the association to achieving a uniform state regulatory regime that reflects the realties of today's marketplace and is rapidly adjustable to the marketplace of tomorrow.

Two of our public policy principles relate specifically to speed to market concerns. They are:

- Market Pricing – States should eliminate the approval process for pricing insurance products. The insurance company must have the responsibility and opportunity to price its product based upon its own market research and strategic plan.

- Speed to Market – Combined with market pricing, the regulator must eliminate burdensome and unproductive approval processes that impede delivery of quality products to consumers.

There should be no doubt, however, that the power to make these changes resides in the 50 state capitals and the District of Columbia.

Getting There From Here

NAMIC takes the interest of Congress in the future of insurance regulation seriously. We understand that your affirmation of the McCarran-Ferguson Act in the Gramm-Leach-Bliley Act of 1999 was undertaken with the intention that state insurance regulation would become as efficient as possible to help serve consumers.

These hearings are helpful to the reform process and we welcome them. They keep all parties engaged in the discussion of how competition can be enhanced in all segments of the financial services industry. No insurance company and no state will be unaffected by the outcome of this debate.

The NAIC did well to develop "Statement of Intent" initiative in March 2000 and for focusing its attention on what NAMIC believes is the most pressing market reform issue, speed-to-market.

We are also encouraged by the NAIC's list of rate and form filing recommendations that call for development of checklist standards, a move to a 30-day approval process and consideration of competitive rating standards with little regulatory oversight.

But these are preliminary, critical steps of an important, but nonetheless, voluntary organization.

Ultimately, the accountability for reforming insurance regulation is with state legislatures and they are up to the task.

This is a time of unparalleled unity of purpose among industry and policymakers on the subject of creating a competitive regulatory environment. Given the opportunity to advocate this message strongly, clearly and persuasively, we have a fighting chance to succeed.

Thank you.

Consumer Federation of America

TESTIMONY OF J. ROBERT HUNTER[1],
DIRECTOR OF INSURANCE

BEFORE THE SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
OF THE FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
JUNE 21, 2001

[1] Mr. Hunter served as Federal Insurance Administrator under Presidents Ford and Carter and as Texas Insurance Commissioner. His CV is attached to this testimony as Exhibit A. Neither he, nor CFA, have received any grants or contracts since October 1, 1999 from the federal government related to the subject of this testimony.

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121 • www.consumerfed.org

Let me begin by dispelling a few myths:

- Consumers do *NOT* want speed to market for bad insurance products. These are complex legal documents that consumers cannot readily understand. Consumers need the assurance of review by some regulatory entity. There is no evidence that consumers are clamoring for insurance products with less scrutiny from regulators whose job it is to protect them. Is the pressure for speed to market coming from the victims of life insurance company churning or vanishing premiums? Or from the victims of race-based premiums? Or from the consumers who were sold auto policies without a warning that the parts that would be used to repair their car would be substandard?
- The industry likes to direct policymaker attention to rate deregulation – calling any form of rate regulation "inefficient" or "state-based rates." But they actually seek much more. They want to deregulate policy forms and risk classification systems.
- Deregulation does *NOT* assure more competition or beneficial competition. For instance, deregulated policy forms can make price competition impossible. Simple deregulation in insurance, given the industry's antitrust exemption embodied in the McCarren-Ferguson Act and many state law impediments to competition, will not increase competition.
- Competition is *NOT* always beneficial for consumers. Some forms of competition are harmful to consumers (e.g., reverse competition in credit insurance where the competition is for the bank or car dealer and the competition drives rates up to allow bigger kickback commissions; fine-print competition where insurers hollow out coverage with clever policy language to offer low rates with high profit and selection competition such as redlining of the inner cities).
- Just enacting deregulation without making competition effective will not produce the best results for consumers. Prior approval regulation, if intelligently coupled with pro-competitive laws, work best. The state in the nation with the best practices for auto insurance regulation is California, where Proposition 103 enacted by the people of the State in 1988 both assured competition and strengthened regulation. Since 1988, California rates have fallen 12% while the typical state rates rose almost 40%, and the profits in California for insurers have been the highest of any state.
- Consumers do *NOT* care who regulates insurance, the federal government or the states. Consumers only care that the consumer protections afforded be excellent.
- Consumers do *NOT* favor a system where the regulated get to choose who regulates them. That is a sure prescription for a race to the bottom for insurance regulation.
- Consumers do care that the insurers have been blatantly using the threat of congressional interest, including this hearing, to bludgeon the NAIC and the states into submission for their inappropriate ideas to cut away vital consumer protections. Congress should make it clear to the states that, while unnecessary fat in the regulatory process should be eliminated, the states should not cut away any necessary consumer protections.
- Consumers want functional regulation to mean more effective consumer protection and not simply be a euphemism for regulatory arbitrage. Federal and state banking and insurance regulators must work together to ensure that insurers do not create a competition among regulators for the least consumer protection.
- The so-called "academic" studies of regulation should be viewed with skepticism as these studies and their authors are either funded directly or indirectly by the insurance

industry. While the industry has unlimited resources – typically gained from premiums paid by consumers – to buy the research that fits their deregulation agenda, consumers must rely upon the volunteer efforts of advocates.

Background

The financial services marketplace is experiencing rapid change. The Gramm-Leach-Bliley Act ("GLB") hastened the mergers and diversification already happening among financial firms. New product designs, faster ways of accessing money from more sources and e-commerce all hold great potential for consumers. But they also expose consumers to risk of loss, especially when consumers lack information about policies and their value.

Unfortunately, consumer laws have not kept pace with the changes, especially in the area of insurance. Dramatic improvements in insurance regulation are needed to promote beneficial competition and protect insurance consumers.

In response to the passage of the GLB law and federal encroachment on state-based insurance regulation, the states and the NAIC have embarked on a timely and much-needed "reinvention" of insurance regulation process.

Consumers have supported much of the change NAIC proposes to obtain greater speed to market for the insurers. Indeed, I served as one of the consumer representatives on the Speed to Market Committees of the NAIC over the last year and a half. Consumers identified many ways that states could shorten the regulatory process. We supported a 30-day limit on final action, for example and an end to unknown rules for regulatory action, known as "desk-drawer" rules. What we do not support is "mindless" deregulation that some of the insurers advocate.

We define "mindless deregulation", as taking the position that just stopping regulation will make competition happen. There is simply no evidence of this. In fact, given the industry's antitrust exemption nationally and in most states, simple deregulation will not succeed. Further, most states have retail price maintenance laws on the books so that agents don't compete with each other within a single company (just like refrigerator dealers did not compete prior to the striking down of wholesale level control over the retail prices). In some states groups cannot form to buy insurance. Anti-competitive practices, such as joint use of future cost projections in pricing, are commonplace.

As the reinvention process proceeds, it is useful to assess the rationale for and record of insurance regulation and determine how and what changes can be made to help ensure the needs of all stakeholders, including consumers and the industry, are met.

The Rationale and Record of Insurance Regulation

We suggest that the rationale behind insurance regulation is to promote beneficial competition and prevent destructive or harmful competition in various areas.

Insolvency: One of the reasons for regulation is to prevent competition that routinely causes insurers to go out of business and leave consumers unable to collect on claims. Insolvency regulation has historically been a primary focus of insurance regulation. After several insolvencies in the 1980s, state regulators and the NAIC enacted risk-based capital standards and implemented the accreditation program to help prevent and identify future insolvencies. The 1990s experienced far fewer insolvencies and state regulation appears to be doing a good job, though the strong securities markets have helped shore up companies' retained earnings, called "surplus." Some changes were made in the guaranty fund system but there are still some significant gaps in the protection for consumers.

Unfair and Deceptive Policies and Practices: Insurance policies, unlike other consumer products or services, are complex legal contracts that promise to make certain payments under certain conditions and at some point in the future. Whereas a consumer can easily research the price, quality and features of a television, the consumer has very limited ability to do so on insurance policies. Because of the complicated legal nature of insurance policies, the consumer relies on the representations of the seller/agent to a far greater extent than for other products. Regulation exists to prevent competition that causes unfair and deceptive policies, sales and claims practices. An example of competition that is adverse to consumers in this area is what we term "fine-print" competition, where insurers compete for profits by deceptive policy provisions that reduce coverage.

Unfortunately, states have not fared as well in controlling unfair and deceptive policies and practices. Rather than acting as the instigator of enforcement actions, states more often have *reacted* after lawsuits or news stories brought bad practices to light. For example, the common perception among regulators that "fly-by-night" companies were the ones to fear was shattered by widespread allegations of misleading and deceptive practices by household names such as MetLife, John Hancock, and Prudential. Though it is true that state regulators eventually took action, e.g., coordinated massive settlements, the allegations were first raised in private litigation.

One of the problems insurance departments face is a lack of resources for market conduct regulation. Consumer Federation of America's (CFA) recent survey indicates it would take five to seven years for states to complete market conduct exams on all of their domestic companies, over 50 years for all companies. Only 15 of the jurisdictions meet the standard of devoting 10% of premium taxes to regulation. This means that states making up 75% of the country's population have inadequate resources. It is not surprising that many of the industry's bad practices fall through the cracks. 15 states perform no market conduct exams at all.

So things go through this porous sieve, e.g.:

- Though banned in rating over three decades ago, life insurance companies have used race in rating older policies since that time.
- States now are investigating alleged unfair claims practices (the use of bogus medical reasons to deny claims for injuries) of State Farm after the television news show *Dateline* aired a story about several lawsuits against the insurer.

While the industry and some regulators criticize it, litigation has been a better market conduct enforcement tool in many instances than state regulation. Mindless deregulation will surely be a bonanza to the trial bar as it is certain that more bad products/practices will be in the market if deregulation occurs.

Insurance Availability: Some insurance is mandated by law or required for other activities (e.g., mortgage). In a normally competitive market, insurers compete on the basis of selection of consumers. Selection competition leads to availability problems and redlining.[2] Regulation exists to limit destructive selection competition.

Lawsuits brought by fair housing groups and the Department of Housing and Urban Development (HUD) reveal availability and unfair discrimination exist but demonstrate a lack of oversight and attention by many of the states. NAIC had ample opportunity after its own studies indicated a problem to move in the direction of protecting consumers but retreated when the industry threatened to cut off database funding, a primary source of NAIC funds.

The industry has been adamantly opposed to disclosure of zip code data and underwriting guidelines. Such disclosure would promote competition and benefit consumers but states, for the most part, have refused to require such disclosure, apparently agreeing with the industry that such information is "trade secret" despite the absence of legal support for such position. In addition, though insurance companies want to compete with banks that come under Community Reinvestment Act ("CRA") requirements of data disclosure and addressing needs of underserved communities, they refuse to acknowledge a similar responsibility to communities.

Reverse Competition: In certain lines of insurance, insurers market their policies to a third party, e.g., creditors or auto dealers, who, in turn, sell the insurance to consumers on behalf of the insurer for commission and other compensation, often not disclosed to the consumer. Absent regulation, reverse competition leads to higher, not lower prices for consumers because the higher the price the higher the compensation for third party sellers.

Every few years, consumer groups issue reports on the millions of dollars overcharged for consumer credit insurance. Despite the overwhelming evidence that insurers do not meet targeted loss ratios in most states, most states have not acted to protect consumers by lowering rates.

Low value life insurance and industrial life insurance, markets characterized by overpriced and inappropriately sold policies and a lack of competition, demonstrate the need for standards that ensure value and honest disclosure. Insurers rely on consumers' lack of sophistication to sell these overpriced policies. With some exceptions, states have not enacted standards that ensure

[2] The industry's reliance on selection competition can have negative impacts on consumers. Insurance is a risk spreading mechanism. Insurance aggregates consumers' premiums into a common fund from which claims are paid. Insurance is a contractual social arrangement, subject to regulation by the states.

The fact of the common fund in which wealth is shifted from those without losses (claims) to those with losses (claims) is why the contribution of insurance companies to the Gross National Product of the United States is measured as premiums less losses for the property/casualty lines of insurance. The U.S. government recognizes that the losses are paid from a common fund and thus are a shift in dollars from consumers without claims to those with claims, not a "product" of the insurance companies.

Competition among insurers should be focused where it has positive effects, e.g., creating efficiencies, lowering overhead. But rather than competing on the basis of the expense and profit components of rates, the industry has relied more on selection competition, which merely pushes claims from insurer to insurer or back on the person or the state. States have failed to control against the worst ravages of selection competition (e.g. redlining).

Some of the vices of selection competition that need to be addressed include zip code or other territorial selection; the potential for genetic profile selection; income (or more precisely credit report) selection; selection based on employment. Targeted marketing based solely on information such as income, habits, preferences, etc. leaves consumers in need of insurance out, perhaps unfairly. The data being collected by the web and otherwise can be used to profile for selection.

value or provide timely, accurate disclosure. Consumers continue to pay far too much for very little coverage.

Information for Consumers: True competition can only exist when purchasers are fully aware of the costs and benefits of the products and services they purchase. Because of the nature of the policies and pricing, consumers have had relatively little information about the quality and comparative cost of insurance policies. Regulation is needed to ensure consumers have access to information necessary to make informed insurance purchase decisions and to compare prices. Some states have, according to studies by CFA, done fairly well at getting good information out to consumers but all too often the marketplace and insurance regulators have failed to ensure adequate disclosure. Their failure affects the pocketbooks of consumers, who cannot compare adequately on the basis of price.

For decades, consumer advocates pressed for more meaningful disclosure for life insurance, including rate of return disclosure. Then the widespread misleading and abusive practices by insurance companies and agents of the mid-90s prompted state regulators, through the NAIC, to develop model illustration laws and other laws to address the problems. Regulators voiced strong concern and promised tough action to correct the abuses. While early drafts held promise and included some cost-comparison requirements, the industry successfully lobbied against the pro-consumer provisions. The disclosure model that NAIC adopted is inadequate for consumers to understand the structure and actual costs of policies or to comparison-shop.

While information and outreach efforts of states have improved, states and the NAIC have a long way to go. Few, if any, states provide information to consumers about their rights vis-a-vis their insurance policies. The NAIC's website does not focus on consumers, although there is a move that has just begun to make it more so. CFA's studies on consumer outreach reveal gaps in information. For example: 22 states have no auto insurance price guide; 34 states have no homeowners insurance price guide; and only 6 states have comprehensive health price guides. No state has a life insurance price guide. In a majority of the states, consumers do not have access to complaint ratio information for auto, homeowners, health or life insurance.

States have done somewhat better in getting information up on web pages. However, many offer no price information or complaint ratio information. Further, the states have not set up electronic rate filings as a way to assist private price vendors get quote service data updates automatically, despite repeated requests from consumers for such a system. The NAIC has a national complaint database that consumers have asked be released for years but it still languishes in the computers, not helping consumers determine which companies offer good service. Fortunately, at the NAIC meeting just concluded in New Orleans, the NAIC voted to make this data public by the end of the year.

Are the reasons for insurance regulation still valid in the wake of the GLB law? We believe that the reasons for regulation are as relevant, or in some instances even more relevant, today than five or ten years ago:

- Advances in technology allow insurers to pursue selection competition to an extent unimaginable ten years ago and give insurers access to detailed data about customers.
- Advances in technology allow insurers to reach consumers in ways not possible ten years ago.

- Insurance is being used as a tool to fund a greater share of a person's future income, e.g., annuities.
- Competition from other financial firms for the same customers can serve as an incentive for misleading and deceptive practices and market segmentation, leaving some consumers without access to the best policies and rates.
- Combination of insurer and lender functions under one corporation will lead to even greater incentives to sell inappropriate add-on insurance – or to inappropriately fund insurance policies through high cost loans – making some products subject to abuse.

As consumers are faced with these changes, it is more important than ever that insurance laws be updated and the consumer protection bar raised.

Is the NAIC Moving in the Right Direction for Consumers?

We strongly agree that dramatic improvements in insurance regulation are needed. Although the NAIC declares that the primary purpose of regulation is to protect insurance consumers, it is unfortunately clear that the NAIC approach is leading toward mindless deregulation (without the application of antitrust laws or informed consumers) of the kind sought by the insurance industry.

We can tell you with certainty that consumers, who have been the victims of vanishing premiums, churning, race-based pricing, creaming, and consumer credit insurance policies that pay pennies in claims per dollar in premium, are NOT clamoring for such policies to be brought to market with even less regulatory oversight than in the past. We think smarter, more efficient regulation benefits both consumers and insurers and leads to more beneficial competition.

We question the entire premise behind less front-end regulation coupled with more back-end (market conduct) regulation. The track record of market conduct regulation has been extremely poor. As noted above, insurance regulators rarely are the first to identify major problems in the marketplace.

From an efficiency and consumer protection perspective, it makes no sense to lessen efforts to prevent the introduction of unfair and inappropriate policies in the marketplace. It takes far less effort to prevent an inappropriate insurance policy or market practice from being introduced than to examine the practice, stop a company from doing it and providing proper restitution to consumers after the fact. The deregulation pushed by the industry will surely be a class-action attorney's dream come true.

The unique nature of insurance policies and insurance companies requires more extensive front-end regulation than other consumer commodities. And while insurance markets can be structured to promote beneficial price competition, deregulation does not lead to, let alone guarantee, such beneficial price competition.

We think front-end regulation should be designed to prevent market conduct problems from occurring instead of inviting those problems to occur. We think front-end regulation should be designed to promote beneficial competition – price competition, loss mitigation efforts – and to deter destructive competition – selection competition, unfair sales and claims settlement practice. Simply stated, strong, smart, efficient and consistent front-end regulation is critical for meaningful consumer protection and absolutely necessary to any meaningful modernization of insurance regulation.

The following principles and standards for insurance regulation will serve as the measure for consumers of NAIC's (or a federal bill's) commitment to consumer protection in the reinvention process. The consumer representatives presented the principles and standards to the NAIC in September of 2000.

Consumer Principles and Standards for Insurance Regulation

1. Consumers should have access to timely and meaningful information of the costs, terms, risks and benefits of insurance policies.

    - Meaningful disclosure prior to sale tailored for particular policies and written at the education level of average consumer sufficient to educate and enable consumers to assess particular policy and its value should be required for all insurance; should be standardized by line to facilitate comparison shopping; should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); should address non-English speaking or ESL populations.
    - Insurance departments should identify, based on inquiries and market conduct exams, populations that may need directed education efforts, e.g., seniors, low-income, low education.
    - Disclosure should be made appropriate for medium in which product is sold, e.g., in person, by telephone, on-line.
    - Loss ratios should be disclosed in such a way that consumers can compare them for similar policies in the market, e.g., a scale based on insurer filings developed by insurance regulators or independent third party.
    - Non-term life insurance policies, e.g., those that build cash values, should include rate of return disclosure. This would provide consumers with a tool, analogous to the APR required in loan contracts, with which they could compare competing cash value policies. It would also help them in deciding whether to buy cash value policies.
    - Free look period with meaningful state guidelines to assess appropriateness of policy and value based on standards the state creates from data for similar policies.
    - Comparative data on insurers' complaint records, length of time to settle claims by size of claim, solvency information, and coverage ratings (e.g., policies should be ranked based on actuarial value so a consumer knows if comparing apples to apples) should be available to the public.
    - Significant changes at renewal must be clearly presented as warnings to consumers, e.g., changes in deductibles for wind loss.
    - Information on claims policy and filing process should be readily available to all consumers and included in policy information.
    - Sellers should determine and consumers should be informed of whether insurance coverage replaces or supplements already existing coverage to protect against over-insuring, e.g., life and credit.
    - Consumer Bill of Rights, tailored for each line, should accompany every policy.
    - Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurer should give consumer

notice of feedback procedure at end of transaction, e.g., form on-line or toll-free telephone number.

2. Insurance policies should be designed to promote competition, facilitate comparison-shopping and provide meaningful and needed protection against loss.

    - Disclosure requirements above apply here as well and should be included in design of policy and in the policy form approval process.
    - Policies must be transparent and standardized so that true price competition can prevail. Components of the insurance policy must be clear to the consumer, e.g., the actual current and future cost, including commissions and penalties.
    - Suitability or appropriateness rules should be in place and strictly enforced, particularly for investment/cash value policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.
    - "Junk" policies, including those that do not meet a minimum loss ratio, should be identified and prohibited. Low-value policies should be clearly identified and subject to a set of strictly enforced standards that ensure minimum value for consumers.
    - Where policies are subject to reverse competition, special protections are needed against tie-ins, overpricing, e.g., action to limit credit insurance rates.

3. All consumers should have access to adequate coverage and not be subject to unfair discrimination.

    - Where coverage is mandated by the state or required as part of another transaction/purchase by the private market, e.g., mortgage, regulatory intervention is appropriate to assure reasonable affordability and guarantee availability.
    - Market reforms in the area of health insurance should include guaranteed issue and community rating and where needed, subsidies to assure health care is affordable for all.
    - Information sufficient to allow public determination of unfair discrimination must be available. Zip code data, rating classifications and underwriting guidelines, for example, should be reported to regulatory authority for review and made public.
    - Regulatory entities should conduct ongoing, aggressive market conduct reviews to assess whether unfair discrimination is present and to punish and remedy it if found, e.g., redlining reviews (analysis of market shares by census tracts or zip codes, analysis of questionable rating criteria such as credit rating), reviews of pricing methods, reviews of all forms of underwriting instructions, including oral instructions to producers.
    - Insurance companies should be required to invest in communities and market and sell policies to prevent or remedy availability problems in communities.
    - Clear anti-discrimination standards must be enforced so that underwriting and pricing are not unfairly discriminatory. Prohibited criteria should include race, national origin, gender, marital status, sexual preference, income, language, religion, credit history, domestic violence, and, as feasible, age and disabilities. Underwriting and rating classes should be demonstrably related to risk and backed by a public, credible statistical analysis that proves the risk-related result.

4. All consumers should reap the benefits of technological changes in the marketplace that decrease prices and promote efficiency and convenience.

    - Rules should be in place to protect against redlining and other forms of unfair discrimination via certain technologies, e.g., if companies only offer better rates, etc. online.
    - Regulators should take steps to certify that online sellers of insurance are genuine, licensed entities and tailor consumer protection, UTPA, etc. to the technology to ensure consumers are protected to the same degree regardless of how and where they purchase policies.
    - Regulators should develop rules/principles for e-commerce (or use those developed for other financial firms if appropriate and applicable)
    - In order to keep pace with changes and determine whether any specific regulatory action is needed, regulators should assess whether and to what extent technological changes are decreasing costs and what, if any, harm or benefits accrue to consumers.
    - A regulatory entity, on its own or through delegation to independent third party, should become the portal through which consumers go to find acceptable sites on the web. The standards for linking to acceptable insurer sites via the entity and the records of the insurers should be public; the sites should be verified/reviewed frequently and the data from the reviews also made public.

5. Consumers should have control over whether their personal information is shared with affiliates or third parties.

    - Personal financial information should not be disclosed for other than the purpose for which it is given unless the consumer provides prior written or other form of verifiable consent.
    - Consumers should have access to the information held by the insurance company to make sure it is timely, accurate and complete. They should be periodically notified how they can obtain such information and how to correct errors.
    - Consumers should not be denied policies or services because they refuse to share information (unless information needed to complete transaction).
    - Consumers should have meaningful and timely notice of the company's privacy policy and their rights and how the company plans to use, collect and or disclose information about the consumer.
    - Insurance companies should have clear set of standards for maintaining security of information and have methods to ensure compliance.
    - Health information is particularly sensitive and, in addition to a strong opt-in, requires particularly tight control and use only by persons who need to see the information for the purpose for which the consumer has agreed to sharing of the data.
    - Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

6. Consumers should have access to a meaningful redress mechanism when they suffer losses from fraud, deceptive practices or other violations; wrongdoers should be held accountable directly to consumers.

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. Unfair trade practices acts should provide private cause of action.
- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.
- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be independent, fair and neutral decision-maker.
- Private attorney general provisions should be included in insurance laws.
- There should be an independent agency that has as its mission to investigate and enforce deceptive and fraudulent practices by insurers, e.g., the reauthorization of FTC.

7. Consumers should enjoy a regulatory structure that is accountable to the public, promotes competition, remedies market failures and abusive practices, preserves the financial soundness of the industry and protects policyholders' funds, and is responsive to the needs of consumers.

- Insurance regulators must have clear mission statement that includes as a primary goal the protection of consumers:
    - The mission statement must declare basic fundamentals by line of insurance (such as whether the state relies on rate regulation or competition for pricing). Whichever approach is used, the statement must explain how it is accomplished. For instance, if competition is used, the state must post the review of competition (e.g., market shares, concentration by zone, etc.) to show that the market for the line is workably competitive, apply anti-trust laws, allow groups to form for the sole purpose of buying insurance, allow rebates so agents will compete, assure that price information is available from an independent source, etc. If regulation is used, the process must be described, including access to proposed rates and other proposals for the public, intervention opportunities, etc.
- Consumer bills of rights should be crafted for each line of insurance and consumers should have easily accessible information about their rights.
    - Insurance departments should support strong patient bill of rights.
- Focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within regulatory body should be established for education and outreach to consumers, including providing:
    - Interactive websites to collect from and disseminate information to consumers, including information about complaints, complaint ratios and consumer rights with regard to policies and claims.
    - Access to information sources should be user friendly.
    - Counseling services to assist consumers, e.g., with health insurance purchases, claims, etc. where needed should be established.
- Consumers should have access to a national, publicly available database on complaints against companies/sellers, i.e., the NAIC database.

- To promote efficiency, centralized electronic filing and use of centralized filing data for information on rates for organizations making rate information available to consumers, e.g., help develop the information brokering business.
- Regulatory system should be subject to sunshine laws that require all regulatory actions to take place in public unless clearly warranted and specified criteria apply. Any insurer claim of trade secret status of data supplied to regulatory entity must be subject to judicial review with burden of proof on insurer.
- Strong conflict of interest, code of ethics and anti-revolving door statutes are essential to protect the public.
- Election of insurance commissioners must be accompanied by a prohibition against industry financial support in such elections.
- Adequate and enforceable standards for training and education of sellers should be in place.
- The regulatory role should in no way, directly or indirectly, be delegated to the industry or its organizations.
- The guaranty fund system should be prefunded, national fund that protects policyholders against loss due to insolvency. It is recognized that a phase-in program is essential to implement this recommendation.
- Solvency regulation/investment rules should promote a safe and sound insurance system and protect policyholder funds, e.g., rapid response to insolvency to protect against loss of assets/value.
- Laws and regulations should be up to date with and applicable to e-commerce.
- Antitrust laws should apply to the industry.
- A priority for insurance regulators should be to coordinate with other financial regulators to ensure consumer protection laws are in place and adequately enforced regardless of corporate structure or ownership of insurance entity. Insurance regulators should err on side of providing consumer protection even if regulatory jurisdiction is at issue. This should be stated mission/goal of recent changes brought about by GLB law.
  - Obtain information/complaints about insurance sellers from other agencies and include in databases.
- A national system of "Consumer Alerts" should be established by the regulators, e.g., companies directed to inform consumers of significant trends of abuse such as race-based rates or life insurance churning.
- Market conduct exams should have standards that ensure compliance with consumer protection laws and be responsive to consumer complaints; exam standards should include agent licensing, training and sales/replacement activity; companies should be held responsible for training agents and monitoring agents with ultimate review/authority with regulator. Market conduct standards should be part of an accreditation process.
- The regulatory structure must ensure accountability to the public it serves. For example, if consumers in state X have been harmed by an entity that is regulated by state Y, consumers would not be able to hold their regulators/legislators accountable to their needs and interests. To help ensure accountability, a national consumer advocate office with the ability to represent consumers before each insurance department is needed when national approaches to insurance regulation or "one-stop" approval processes are implemented.
- Insurance regulator should have standards in place to ensure mergers and acquisitions by insurance companies of other insurers or financial firms, or changes in status of insurance

companies (e.g., demutualization, non-profit to for-profit), meet the needs of consumers and communities.
- Penalties for violations must be updated to ensure they serve as incentives against violating consumer protections and should be indexed to inflation.

8. Consumers should be adequately represented in the regulatory process.

- Consumers should have representation before regulatory entities that is independent, external to regulatory structure and should be empowered to represent consumers before any administrative or legislative bodies. To the extent that there is national treatment of companies or "one-stop" (OS) approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the OS state or any other approving entity.
- Insurance departments should support public counsel or other external, independent consumer representation mechanisms before legislative, regulatory and NAIC bodies.
- Regulatory entities should have well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., consumer advisory committee. This is particularly true to ensure needs of certain populations in state and needs of changing technology are met.

<u>Speed to Market</u> –

You requested my analysis of the NAIC activities in achieving Speed to Market. I would say that the NAIC has moved faster on this set of priorities than I have experienced in my over 40 years of observing their activities. Nothing motivates like fear of loss of turf. And, they have done much to undermine necessary consumer protections in the process.

The two (CARFRA and Improvements to State Based Systems Subgroup – ISBSS) Speed to Market subgroup's activities last year were biased towards insurers and against consumer protections. Both of the subcommittees' actions virtually ignored the consumer representatives' white paper recommendations.

For example, the CARFRA subcommittee's proposal ignored the need for a dedicated consumer advocate to participate in the CARFRA review process, the need for consumer representation on the CARFRA Board, and the need for dedicated funding outside of insurer control. The life insurers complained about public access to information during the CARFRA review process, so public access during the review period was totally eliminated. This decision, of course, eliminates even the modest opportunity for consumer input into the CARFRA review contained in the draft proposal, reducing rights consumers currently enjoy in several states.

The property casualty insurers complained that CARFRA would "centralize" insurance regulation and demanded that the CARFRA launch be limited to life products. The NAIC agreed, even though the same need exists for property casualty products as for life products to improve the quality and consistency of regulatory reviews across states. The abandonment of property casualty products – during a test period! – means that consumers have no hope of strengthening state insurance regulation for these products through the CARFRA process.

The bias towards insurers was further demonstrated when Commissioner Fitzgerald, co-chair of the subcommittee, explained the abandonment of property casualty products from CARFRA by saying that the "customers" did not want it. While it was refreshing to hear an insurance regulator speak honestly about whom regulators serve, consumers are also customers and the NAIC ignored its pledge, in the Statement of Intent that it would seek to protect consumers "proactively and aggressively." We are customers who want the quality of property casualty filings review improved across the states, not eliminated in a rush to keep insurers from seeking a federal option.

At the same time that CARFRA dropped review of property/casualty filings, the Improvements to State Based Systems (ISBSS) subcommittee adopted commercial lines deregulation unaccompanied by improvements in other regulatory tools.

The ISBSS gave insurers commercial lines deregulation in place by mid-2001 while paying lip service (through mere promises of possible future charges and studies perhaps starting at the end of 2001) to consumer information, market monitoring information and consumer representation in the regulatory process. They punted on data disclosure for the public to monitor redlining. The subgroup ignored the problem of selection competition. While urging regulators to find a way to implement commercial lines deregulation even if the state regulatory framework called for prior approval or file and use, the subgroup simply advised regulators to follow state law and technical capabilities when it came to consumer access to information.

We spent a lot of time providing detailed comments to the Speed to Market working group. They accepted many of our proposals for cutting unnecessary regulations and putting a 30 day time limit on review of filings, but they rejected all of our requests to couple commercial lines deregulation with enhanced consumer information. We asked for a point-by-point explanation of why the working group rejected all our recommendations (in executive session). We were never told despite repeated requests for such information.

Consumers agreed with the bulk of the regulatory efficiency improvements suggested by the industry and even suggested many ourselves.

COMMERCIAL LINES

Consumers do not mind certain deregulatory efforts. For example, we agree that large commercial accounts do not need regulation of any sort, either for the policy forms or rates.

As to small businesses, we believe that they are no more sophisticated than ordinary consumers are. A driver of a one-truck delivery business does not have risk managers and/or lawyers to call on to analyze a policy. Prior approval form regulation is required to assure this small business that the complex legal contract being tendered is what it seems to be.

Even as to rates, prior approval regulation is needed. The rating systems include territories, classifications, underwriting rules and other very complex systems that have significant public policy implications. (See Personal Lines immediately below).

PERSONAL LINES

The NAIC has begun in 2001 a review of personal lines regulation. That led consumer groups to undertake a major review of regulatory regimes throughout the nation to determine which system works best for consumers.

Policy forms are complex legal documents that need to be regulated so that consumers are not misled into buying what appears to be a low-cost policy only to find, when a claim is filed, that the cost is low because the fine print has removed almost all of the coverage.

One of the most pressing issues in insurance today is the increasing use of non-risk related factors by insurers to determine a consumers premium. With increased access to consumers personal information and cheap computing power, insurers are developing ever more refined risk classification systems that reward segments of their market– typically white and affluent – and penalize others – typically poor and minority. Insurers' use of consumes credit history for underwriting and rating is the prime example. For some insurers, a consumer's credit history carries more weight in determining the premium than driving record. The determinations about how we group consumers for purposes of assigning premium is a profound public policy decision. Left to unfettered market forces, health insurers would only insurer healthy people. Greater – certainly not lesser – regulatory oversight of risk classifications is necessary.

Another recent class being tested is the use of global positioning satellites (GPS) in insured autos. This presents obvious questions of privacy and fairness. The insurer using this system in the test, Progressive, says people who drive at night will pay more. Is it fair to make a person who must work the swing shift pay more because he drives during a time when more drinkers drive? If I stop at my health club but the GPS sees me parked across the street near Mike's Bar and Grill, should I pay more?

And what's next? I guarantee you that life and health insurers will use the genome to rate risk. Is that good? Is it bad? Should that decision be unregulated by some public entity?

The standards we used to measure the excellence of regulation were based upon our principles and standards set forth above. They include that the law:

- Make regulation easily understood by, responsive to, accountable to and inspire confidence from the public and regulated entities.
- Promote beneficial competition towards the end of fair profits for regulated entities and fair treatment of consumers.
- Make public policy the primary determinant of risk classification schemes.
- Provide for public involvement in the regulatory process, including institutionalized consumer participation in review of forms, manuals and rates.
- Provide the regulator, regulated entities and the public with the tools to identify market problems and harmful competition such as redlining.
- Prevent harmful products from coming to market, deter regulated entities from unfair and harmful practices, stop harmful practices from continuing and provide restitution to consumers injured by harmful and unfair practices of regulated entities.
- Promote loss prevention and loss mitigation as the most important way for insurers to manage exposure.

By these measures, one state, California, stands out as the state with the statutory provisions that most meet these standards. The people of California put most of these provisions into place by the 1998 enactment of Proposition 103. We particularly like the Proposition's powerful combination of increased competition through repeal of the state antitrust exemption, repeal of the anti-rebate law, repeal of the anti-group law and so on, coupled with strong regulatory back up. This combination works to give the consumers of California the best system in the nation.

We then tested California's performance since Prop 103 became effective to determine if these best provisions really produced the expected positive results for consumers and for the insurers as well. Among our remarkable findings were:

- Auto insurance rates went down in California by 12.0% while nationally, in the typical state, rates were rising by almost 40%.
- California has enjoyed the lowest rate change of any state in the nation since the adoption of Proposition 103.
- The savings enjoyed by Californians total nearly $30 billion.
- Rate rollbacks totaling $1.3 billion were paid to consumers.
- Loss costs were controlled by the strong incentives for driver safety built into the initiative. "Clean" drivers received a 20% discount. They also gained the right to buy insurance from the company of their choice.
- Insurer expenses were reduced by the system of disallowing excess expenses and fines, coupled with increased competitive pressure.
- In 1989 8.4% of the insureds in California were in the Assigned Risk Plan. In 1999, the percentage had fallen to 0.3%. This represents an astounding drop in the Assigned Risk Plan of 96%.
- From 1989 to 1997, the uninsured motorist population declined 38%.
- There was entry and exit consistent with a competitive industry. The number of insurer groups competing in the state increased by 17%.
- Proposition 103 produced excellent profits for insurers; the highest in the nation.
- Proposition 103 encouraged a national movement by insurers to fight fraud, push for safety and cut costs.

CFA has presented this study to the NAIC and has forwarded it to each of the 50 state insurance commissioners. It is available on the CFA web page at www.consumerfed.org.

As you think about Proposition 103's achievements, don't forget to compare it to other major regulatory changes in recent years. In California alone there have been three major changes. First, Prop 103 moved insurance from deregulation to regulation and real competition. Two other regulatory changes in California went from regulation to deregulation. Electricity, about which I will not comment, and workers compensation insurance. It is now in crisis with 8 of the 12 top writers now in solvency trouble.

Recommendations to Congress

1. We ask Congress not to allow the industry to continue to use you as a threat to gain the mindless deregulatory changes they propose.
2. We request that you carefully consider all proposals that come before you to see that the principles and standards we have set out for consumer protection are part of any Congressional action you take.
3. Please reject any system that gives the regulated an option to go back and forth between regulators, playing them off against each other to lower protections. Any optional system must contain minimum standards for both regulatory regimes, high standards based upon the above principles.
4. We recommend that you look to California for a model personal lines regulatory system that works best for consumers and gives excellent profits to consumers as well.

the anti-rebate law, repeal of the anti-group law and so on, coupled with strong regulatory back up. This combination works to give the consumers of California the best system in the nation.

We then tested California's performance since Prop 103 became effective to determine if these best provisions really produced the expected positive results for consumers and for the insurers as well. Among our remarkable findings were:

- Auto insurance rates went down in California by 12.0% while nationally, in the typical state, rates were rising by almost 40%.
- California has enjoyed the lowest rate change of any state in the nation since the adoption of Proposition 103.
- The savings enjoyed by Californians total nearly $30 billion.
- Rate rollbacks totaling $1.3 billion were paid to consumers.
- Loss costs were controlled by the strong incentives for driver safety built into the initiative. "Clean" drivers received a 20% discount. They also gained the right to buy insurance from the company of their choice.
- Insurer expenses were reduced by the system of disallowing excess expenses and fines, coupled with increased competitive pressure.
- In 1989 8.4% of the insureds in California were in the Assigned Risk Plan. In 1999, the percentage had fallen to 0.3%. This represents an astounding drop in the Assigned Risk Plan of 96%.
- From 1989 to 1997, the uninsured motorist population declined 38%.
- There was entry and exit consistent with a competitive industry. The number of insurer groups competing in the state increased by 17%.
- Proposition 103 produced excellent profits for insurers; the highest in the nation.
- Proposition 103 encouraged a national movement by insurers to fight fraud, push for safety and cut costs.

CFA has presented this study to the NAIC and has forwarded it to each of the 50 state insurance commissioners. It is available on the CFA web page at www.consumerfed.org.

As you think about Proposition 103's achievements, don't forget to compare it to other major regulatory changes in recent years. In California alone there have been three major changes. First, Prop 103 moved insurance from deregulation to regulation and real competition. Two other regulatory changes in California went from regulation to deregulation. Electricity, about which I will not comment, and workers compensation insurance. It is now in crisis with 8 of the 12 top writers now in solvency trouble.

Recommendations to Congress

1. We ask Congress not to allow the industry to continue to use you as a threat to gain the mindless deregulatory changes they propose.
2. We request that you carefully consider all proposals that come before you to see that the principles and standards we have set out for consumer protection are part of any Congressional action you take.
3. Please reject any system that gives the regulated an option to go back and forth between regulators, playing them off against each other to lower protections. Any optional system must contain minimum standards for both regulatory regimes, high standards based upon the above principles.
4. We recommend that you look to California for a model personal lines regulatory system that works best for consumers and gives excellent profits to consumers as well.

Exhibit A

J. ROBERT HUNTER
2202 North 24th Street
Arlington, VA 22207

Summary

Consulting actuary with nearly 40 years of experience with the insurance industry, primarily engaged in analysis of major public policy issues relating to regulatory and consumer issues.

Academic Education

B.Sc. in Physics, Clarkson University, Potsdam, N.Y., 1958.

Professional Qualifications and Professional Association Activities

Casualty Actuarial Society. Fellow (by examination).

American Academy of Actuaries. Member

Experience and Employment

Present

Self-employed consulting actuary.

Also serve as *pro-bono* Director of Insurance for the Consumer Federation of America (CFA). (See "*Pro Bono* Activities," below.)

Employment in the Private Insurance Industry.

1959-1960. **Atlantic Mutual Insurance Companies.** Underwriter, working on several lines of insurance, including commercial property/casualty insurance.

1960-1966. **National Bureau of Casualty Underwriters (NBCU)** (a forerunner organization of the Insurance Services Office (ISO)). I ran their state rate-filing unit, and later became an automobile rate making supervisor in the actuarial department. Duties included: analysis of claims experience for rate making; presentation of the rate requests to the appropriate Bureau committees for action; and presentation of the adopted rate levels to state officials, sometimes in hearings.

1966-1970. **Mutual Insurance Rating Bureau (MIRB) and the Mutual Insurance Advisory Association (MIAA).** I was an Associate Actuary, engaged in activities similar to those in which I was engaged at NBCU, but for all lines of property/casualty insurance (including liability insurance). As an officer of MIRB and MIAA, I dealt directly with the General Manager and was responsible for much of the research undertaken at these organizations.

MIRB/MIAA were forerunner organizations to the Automobile Insurance Plans Service Office ("AIPSO"), the organization charged with servicing and helping run, for the insurance industry, the residual market mechanisms (usually assigned risk plans) for automobile insurance in the U.S.

1970-1980. **Federal Insurance Administration, U. S. Department of Housing and Urban Development**, under HUD Secretary George Romney.

I served in a number of positions, including Chief Actuary, Deputy Federal Insurance Administrator, Acting Federal Insurance Administrator, and Federal Insurance Administrator.

During my ten-year stint in federal insurance regulation (1970-1980), I was involved with insurance-related public policy issues of the highest order. I testified before Congress on many occasions on the programs of the Federal Insurance Administration, as well as on insurance issues generally (such as the purported medical malpractice insurance "crisis" of the mid nineteen-seventies, the costing of health insurance, no-fault auto insurance proposals, and many other issues). I also served on federal inter-agency task forces dealing with products liability insurance, medical malpractice insurance, risk retention group formation, workers' compensation insurance, and other issues.

I was responsible for actuarial and public policy advice to HUD regarding statutory programs (*e.g.* flood insurance, the Riot Reinsurance/FAIR Plan, and Urban Crime Insurance) and many other matters as requested by the White House and other federal agencies. Some examples:

• Administered the FIA's Riot Reinsurance/FAIR Plan program. ("FAIR Plans" are the residual market for fire (homeowners and business properties) insurance. These were usually Joint Underwriting types of organizations.) In my work administering this program, we made many examinations of FAIR Plans, including reviewing claims practices. I participated in writing a book-length overall analysis of the public interest issues involved in residual market insurance (Fair Plan and automobile assigned risk plan) entitled *Full Insurance Availability* (HUD 1974).

• Administered the FIA's flood insurance program, which included both homeowner and business insurance. I monitored claims-paying approaches of the insurance companies that serviced the flood insurance program.

• Wrote the actuarial regulations for President Nixon's temporary 1972 wage- and price-freezing directives as well as for other phases of that program, and helped run some insurance rate cases for the Price Commission.

• Worked with the U.S. Department of Transportation on its landmark no-fault automobile insurance study.

• Worked with the U.S. Department of Labor on workers' compensation insurance matters.

• Worked with the U.S. Federal Trade Commission on life insurance matters.

• Worked with the White House on national health insurance proposals.

I received the HUD Secretary's Award for Excellence by Secretary Carla Hills for the work I performed from 1971-1977.

State Insurance Regulation

1993-94 **Insurance Commissioner of the State of Texas**, appointed by Governor Ann Richards. In charge of the day-to-day operations of the Texas Department of Insurance (TDI). Made all executive decisions on insurance policy matters that arose during my tenure, including rate making, statistical collection, loss prevention, solvency monitoring, residual market issues, enforcement, examination, claims practices, complaint resolution, consumer information dissemination and myriad other matters attendant to running a major government agency such as TDI.

I also undertook a major reorganization of TDI, cutting the staff from 1,100 to about 900 and greatly decentralizing the authority to the

Private passenger automobile insurance ***rate making*** for the Public Advocate of New Jersey, the Public Advocate of South Carolina, the Attorney General of Connecticut, the Attorney General of Massachusetts, the Attorney General of Virginia, the Attorney General of California, the Office of Public Insurance Counsel in Texas and the Departments of Insurance in California, Georgia, New Jersey, North Carolina, and Texas.

Insurance implications of hurricanes as a member of the consulting team for the Academic Task Force in the State of Florida following Hurricane Andrew in 1992.

Antitrust and reinsurance as a member of the Governor's Subcommittee on Antitrust and Reinsurance in Virginia.

Public Policy Research and Testimony

Testified as an actuarial expert on behalf of clients (such as those listed below); on behalf of the private insurance industry when I was employed there during the nineteen-sixties; on behalf of consumer organizations such as NICO, CFA, Consumer's Union (publisher of *Consumer Reports*), Common Cause, and others; on behalf of the States of California, Florida, Massachusetts, New Jersey, New York, North Carolina, Oklahoma, South Carolina and others; and on behalf of the federal government from the 1980s to the early 1990s.

Testified or performed research for federal agencies, including:

U.S. Department of Labor (on Workers' Compensation rate making)

U.S. Department of Health and Human Services (on Medical Malpractice)

U.S. Environmental Protection Agency (on insurance aspects of hazardous waste)

U.S. General Accounting Office (on federal tax policy and rate issues)

The U.S. Congress's Office of Technology Assessment on several issues.

Testified frequently before committees of both the U.S. House of Representatives and the U.S. Senate, as Federal Insurance Administrator, as President of NICO, as Texas Insurance Commissioner, and as Director of Insurance at CFA.

Testified before every state legislature in one forum or another.

News Media Writing and Interviews

Articles published in *The New York Times*, *The Washington Post*, *The Los Angeles Times*, the *Dallas Morning News*, *USA Today*, *The Wall Street Journal*, and other leading newspapers.

Quoted extensively in the insurance industry press and the general media.

Interviews on numerous TV programs, including "Larry King Live," "60 Minutes," "This Week With David Brinkley," "The Today Show," "Good Morning America," "CBS Morning News," "CBS Evening News," "NBC Evening News," "Fox News," "Donahue," and "Oprah Winfrey."

Frequent appearances on radio shows—both news programs (*e.g.* National Public Radio's "All Things Considered") and talk shows (*e.g.* Larry King).

Publications

Published Articles and Papers

2001 J. Robert Hunter, *Why not the Best? The Most Effective Auto Insurance Regulation in the Nation,* (Consumer Federation of America, June 2001). Analyses the state regulatory regimes for auto insurance and concludes that California's system, adopted by a vote of the people of the state in 1988, constitutes the finest regulatory system in the country.

1998 J. Robert Hunter, *America's Disastrous Disaster "System"* (Consumer Federation of America, 1998). Analyzes critically the current approach to handling disasters in this nation and proposes an alternative system that would end taxpayer subsidy of anticipated levels of damage, move the cost of high risk to those who live in high risk areas, and minimize death and damage due to unwise construction practices.

1995 J. Robert Hunter, *Product Liability Insurance Experience, 1984-1993* (1995)

1995 J. Robert Hunter, *Medical Malpractice Insurance Experience, 1984-1993* (1995)

1995 J. Robert Hunter, *Auto Insurance—Progress Through Reform But More To Be Done* (1995)

1994 J. Robert Hunter, "Insuring Against Natural Disaster," *Journal of Insurance Regulation* (1994).

1993 J. Robert Hunter, "Rate Suppression, A Critique", *Journal of Insurance Regulation* (1993).

1985 J. Robert Hunter and Professor Raymond Hill (Princeton University), *Workers' Compensation Insurance Rate making: Regulation of Profit Margins and Investment Income.* (Written under contract for the U.S. Department of Labor.)

1983 J. Robert Hunter, "Study of Feasibility of Risk Retention Groups for Hazardous Waste Facilities," in the *Journal of the Chartered Property Casualty Underwriters' Society*. Addressed the possible use of risk retention groups to ease the tight market for environmental coverage. (Written under contract for the Environmental Protection Agency.)

1983 J. Robert Hunter and Dr. John W. Wilson, *Investment Income and Profitability in Property/Casualty Insurance Rate Making* (1983). Paper was instrumental in convincing the NAIC to adopt "total return rate making procedures" as the preferred rate regulatory model.

Reports

2000 J. Robert Hunter, *Study of State Insurance Departments, Part III: Internet Web Page Grades.* (CFA) This report gave the internet site of the Florida Department of Insurance a grade of "A," which resulted in a DOI press release publicizing the Department's good grade: "Insurance Department Gets 'A' For Consumer-Friendly Web Site, " viewable at http://www.doi.state.fl.us/consumers/alerts/press/2000/pr032400.htm.

2000 J. Robert Hunter, *1988, 1993, and 1998 Changes in State Insurance Department Resources.* (CFA)

1999 *Consumer Information Available From State Insurance Departments.* (CFA)

1999 *Insurance Department Grades for Consumer Complaint Information.* (CFA)

1986 J. Robert Hunter, *Insurance in California: Profitability, Competition and Equity in Selling and Pricing Private Passenger Automobile Insurance and the Crisis in Day Care and Municipal Liability Insurance.* Commissioned by the California legislature. The principal document used by the drafters of Proposition 103 as a blueprint for casualty insurance reform in California.

1984 Series of reports on the interrelationship of gender and miles driven in setting auto insurance rates.

1981 J. Robert Hunter, *Gas Prices and Auto Rates: Insurance Implications of the Dynamic Changes in America's Driving Habits.*

5. J. Robert Hunter, *Taking the Bite Out of Insurance: Investment Income in Rate Making.* Led to a major NAIC study of this issue.

Pro Bono Activities

1980-93 I created an insurance consumer organization, the National Insurance Consumer Organization, which I served *pro-bono.* NICO was the first national organization dedicated to looking at all kinds of insurance (except pensions) from a consumer perspective. It undertook research and advocacy on behalf of consumers, and became the leading voice for consumers on insurance issues.

NICO published information advising consumers how to buy insurance of all types, fielded complaints from consumers, developed a computerized service to help consumers understand cash value life insurance products and otherwise dealt on a daily basis with the needs and concerns of insurance consumers, including their understanding of insurance contracts.

1995 to date Serve *pro-bono* as Director of Insurance for the Consumer Federation of America (CFA), 1424 16th Street, NW, Suite 604, Washington, DC 20036.

TESTIMONY OF PHILIP R. O'CONNOR, PH.D

BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE & GOVERNMENT SPONSORED ENTERPRISES OF THE FINANCIAL SERVICES COMMITTEE OF THE U.S. HOUSE OF REPRESENTATIVES

JUNE 21, 2001

My name is Philip R. O'Connor and I am President of PROactive Strategies, Inc. of Chicago, a consulting firm engaged in research and public policy development in financial and network industries. In addition, I am engaged in the marketing of competitive electric power at the retail level in Northern Illinois as Illinois Market President of AES NewEnergy, Inc. an Illinois licensed Alternative Retail Electric Supplier. From mid-1977 through mid-1982 I served in the Illinois Department of Insurance, first as deputy director for research and urban affairs and then for three years as Director of Insurance.

During my time as Illinois Director of Insurance I had the opportunity to administer an approach to full open competition in property-liability insurance rates, including auto and homeowners. That system, with reliance on the antitrust laws, competition and professional regulation of solvency and market conduct has operated extraordinarily well for thirty years and is a model that other states ought to consider as a replacement for outmoded prior approval regulation.

I appreciate the Subcommittee's invitation to testify and to assist the Subcommittee in its review of conditions in the insurance markets and in the regulation of insurance.

THE NEED FOR A REVIEW OF INSURANCE RATE REGULATION

Approximately half the states have laws that subject property-liability insurance rates, especially rates for personal lines such as auto and homeowners, to some form of prior approval. In the main these laws were enacted in the states at the end of World War II in an effort to substantially maintain the *status quo ante* that existed prior to the wartime decision of the U.S. Supreme Court that insurance was engaged in interstate commerce. Most of the remaining states have laws that presume the existence of a competitive market. In these states, rates may take effect without prior approval but on the basis, in most states, that rates can be reviewed after a finding of a non-competitive market. These competitive pricing laws mainly took effect in the years since the mid-1960s. Some states have moved from prior approval to open competition while several have moved in the other direction.

Much has changed since the late 1940s when our economy was simpler and the notion of a globalized economy had not emerged. Four winds of change have so altered conditions that policymakers should carefully reconsider whether the basic motif of property-liability insurance rate regulation established in the late-1940s should be adhered to.

1) **Computerization and the Internet** have created an environment of "total information" that has accelerated decision making and has broken the near-monopoly on information that large business enterprises may have previously enjoyed.
2) **Globalization** of the economy has made real the formerly theoretical "infinite" mobility of capital. Investment will seek the most favorable environment for growth and return. Many insurers have become global and multi-national enterprises whose capital cannot be considered captive to any given territorial market.
3) **Consumer Power** has never been greater since the purchasing power of the individual family and business has increased dramatically. And in insurance, assuming that regulatory barriers are modest, entry is relatively easy. Therefore consumers can

easily switch their allegiance from one insurer to another. A relatively small number of well-informed, sophisticated consumers can act as leaders having a significant impact on purchasing trends.

4) **Financial Convergence**, abetted by such reform measures as Gramm-Leach-Bliley, is producing more choices of financial products and greater diversity in distribution networks. In addition, most consumers use financial services that are far more complex than auto or homeowners insurance but which are not price regulated.

The mismatch between the market place in 2001 and the insurance rate regulatory framework created in the late-1940s should be reconciled.

THE PAPER: *MODERINZING INSURANCE RATE REGULATION*

In addition to this statement, I have recently co-authored a paper for delivery to the National Conference of Insurance Legislators (NCOIL) in March of this year. That paper, *Modernizing Insurance Rate Regulation: Tacking to the Winds of Change*, presents a review of the varied experiences and conditions in six states. The paper is informed by what we have learned from thirty years of academic and regulator initiated research about the role and effects of the various forms of regulation of property-liability insurance rates by the states. Overall, these six states (Illinois, South Carolina, New Jersey, Massachusetts, California and Texas), each chosen for its salience as an important regulatory example, lend credence to several significant views widely held among academic observers of the insurance regulatory scene.

First, systems that rely on prior approval of insurance rates rather than upon competition to set rate levels create substantial opportunities for market intervention that yields unintended consequences that are not consistent with the interest of consumers seeking to buy insurance coverage. **Second**, heavily regulated systems appear to offer no off-setting benefits for consumers in return for the greater likelihood of other adverse results of rate regulation. **Third**, problems in the insurance market, especially in the personal lines such as auto and homeowners, are not likely to be solved through heavy-handed price regulation and are more likely to be extended and exacerbated by such measures. Market forces appear to do a far better job than regulation of attracting capital to cover consumer risks and to bring rates in line with the actual cost of providing protection against loss.

THIRTY YEARS OF EXPERIENCE AND RESEARCH

These conclusions are in line with thirty years of experience and research that tell us that prior approval states:

- Tend not to keep rates lower than do competitive states;
- In 1999 the 10 most costly auto insurance states had some form of prior approval at that time;
- Have higher exit and lower entry rates of insurance companies;
- Tend to have residual markets (provider of last resort pools) with larger market shares;
- Have more volatile loss ratios as a group than do competitive states;
- As a group have the same long-run average loss ratios as do competitive states;
- Tend to create large cross-subsidies within the voluntary market;
- Tend to create large subsidy flows to the residual markets;
- Send less accurate price signals to consumers about risk and losses;
- Allocate regulatory resources to an unproductive regulatory ritual;
- Tend to make price changes political rather than economic events.

SIX STATES TELL US ABOUT RATE REGULATION

Illinois tells us that operating without any rate regulation at all for property-liability insurance, but relying instead on an antitrust model with aggressive solvency oversight, market conduct exams, consumer complaint resolution and prohibitions on unfair practices such as the use of race or religion in underwriting, produces results so reliable and stable that auto insurance and homeowners insurance rates have disappeared as political and legislative issues over the past three decades. Illinois has consistently been right in the middle of all states in the annual NAIC report on auto insurance rates in the states.

South Carolina tells us that after years of auto insurance market deterioration induced by heavy-handed regulation, a modest movement toward a reliance on price competition can attract new providers and move the market back toward a more normalized condition. Since the insurance reforms of 1997, the market share of the Auto Facility (residual market mechanism), which was 43% and 1 million cars 1992, has fallen by 95% to about 50,000. Loss ratios in the Auto Facility are now comparable to those in the voluntary market. In the 16 years prior to reform, the number of auto insurers operating in the states declined by over 50%. Since the 1997 reforms, more than 100 insurers have entered the state, more than off-setting the 16 year decline.

New Jersey and Massachusetts tell us that state regulation that prescribes auto insurance risk classifications, severely limits rate differentials across territories and imposes long delays on regulatory filings, yields a never-ending set of political controversies, dissatisfied consumers and insurers lined up to leave the market and high prices. Over the past twenty years, the number of auto insurers in Massachusetts has declined by one-half and in New Jersey by one-third. And, in many cases, the insurers operating in these two states are set up as single state insurers in order to limit the exposure of parent companies to adverse regulatory action. New Jersey consistently has the highest auto rates in the country and Massachusetts is always a close runner-up.

California tells us that rate freezes and mandated reductions stimulated by a reaction to temporary, severe market conditions are more likely, over time, to prop rates up above levels that would have prevailed if insurers were not fearful of being trapped in rates lowered to reflect falling loss costs.

Texas tells us that when consumers of insurance products have the choice within the same market of regulated or competitive prices, significant market share will gravitate toward competitive set prices rather than regulated prices. Due to a historical quirk in state insurance laws, larger national insurers have been able to acquire the county mutual insurance companies in Texas. These county mutuals are not subject to rate regulation for homeowners insurance. Homeowners insurance sold by conventional insurers are subject to prior approval rate regulation.

Today, roughly two-thirds of the homeowners market has migrated to the competitively priced market place. Similarly, about one-fourth of the auto insurance market has migrated from regulated rates to competitive rates for coverage sold through "Lloyds" and reciprocal insurance companies that are not rate regulated.

THE ILLINOIS MODEL

The Illinois model is worth focusing on, both because it is not well known outside the state and because it is so simple and successful. After thirty years of operation, the Illinois antitrust pricing model is no longer an experiment or an interesting oddity. It should be seriously considered a model for modernizing insurance rate regulation.

- Illinois has operated since 1971 without a law that subjects property-liability rates to regulatory review or action by reason of excessiveness or inadequacy. This condition came about by accident when, following a two-year experiment with a competitive rating law in place of prior approval, the Illinois General Assembly could not agree on certain features in a revised law. A drafting error prevented the re-imposition of the old prior approval law. As a consequence, Illinois had no rate law and therefore insurers were subject to the antitrust laws in the absence of state regulation pursuant to McCarran-Ferguson. This has been called the "Penicillin Scenario" because it had to have happened by accident since no one would have had the insight or courage to advocate the Illinois model as a policy in 1971. Illinois continues to regulate rates in credit insurance, a line that is characterized by the potential of "reverse competition."

- Residual market mechanisms (the auto assigned risk program and the FAIR plan) are subject to prior approval rate regulation by the Director of Insurance. These plans have far less than one percent of the insured market share (auto .1% and FAIR Plan .4%).
- Insurers are permitted to participate in the joint development of trended (forecasted) loss cost data through licensed advisory organizations.
- In 1982 the Illinois General Assembly, with the support of business and labor and over the opposition of some elements of the insurance industry, made Illinois the first state to move to competition and away from prior approval for workers compensation rates. Many other states have since followed suit. The workers compensation residual market has remained subject to prior approval and has a low population.

- Illinois law still prohibits any different rate to be charged to a consumer by reason of race, color, religion or national origin, nor can auto insurance applications be rejected solely by reason of physical handicap and the law provides for the Director of Insurance and the Attorney General to pursue other unfair competitive practices that the law has not specifically defined.
- For purposes of setting auto liability rates auto insurers may not subdivide a municipality (Chicago).
- The General Assembly has provided for specific, targeted discounts associated with such public policy objectives as encouraging the installation of auto anti-theft devices and senior citizen driver training.
- There are various limitations and disclosure requirements with respect to cancellations and non-renewals of auto and dwelling fire and homeowners policies, information about eligibility for the auto assigned risk plan and FAIR Plan and how to contact the Insurance Department to file a complaint. Premium refund standards are set by law.
- The Illinois Insurance Department requires insurers to individually file illustrative rates for auto and homeowners insurance and personal

lines cancellation, non-renewal and new policy counts by ZIP Code in order to help in the monitoring of competitive developments.

- The Illinois Department also conduct an annual, in-depth review of market conditions and the availability and affordability of personal and commercial property-liability insurance pursuant to Illinois Insurance Cost Containment Act of 1986.

Researcher after researcher has looked at Illinois and Illinois has repeatedly been compared to other states in terms of important outcomes. Illinois consistently fares well. Prices are always right in the middle of all states, residual market populations have been perennially low, over-the-phone price quotes are readily available, the state has the largest number of licensed personal lines insurers, and political controversy is rare and suggestions for a return to prior approval have not been seriously made in many years.

CALIFORNIA AND PROPOSITION 103

In 1988, California voters reacted to a major run-up in auto insurance rates in the mid- to late 1980s by replacing the competitive pricing regime that had existed since 1947 with a prior approval regime for all property-liability insurance other than workers compensation that also sought to roll back rates across the board by 20% relative to 1987 rate levels. Significant litigation and lengthy regulatory proceedings followed and actual implementation of many Prop 103 provisions has been absent or incomplete, including the rate rollbacks.

There is widespread agreement that since 1989 there has been a dramatic drop-off in auto insurance loss costs. After several years of rapidly escalating rates, by 1988, average auto expenditure per insured auto in California were among the ten highest in the country. By 1999, the average expenditure had fallen to the median, with California being slightly more expensive that Illinois. The controversy about California, now as in 1988, is whether prior approval rate regulation as represented by Prop 103 is a help, a non-event or a hindrance for consumer interests.

Recently, Robert Hunter, a former Texas Commissioner of Insurance, authored a paper for the Consumer Federation of America (CFA) that attributes the fall in auto insurance loss costs in California since 1989 to Prop 103. His conclusions are in contrast to my own and those of others, who attribute the decade-long reduction in auto loss costs to other factors more directly associated with accidents, claims and litigation. Further, there is disagreement over the meaning of the agreed-upon fact that since 1989, the average return on capital for insurance operations in California for auto liability insurance has been twice the national average: 14.8% versus 7.25%.

Mr. Hunter's CFA paper has a number of problems that may have led to conclusions that are likely well off the mark. The critical element of the CFA paper is the belief that Prop 103 has, in some way, incented drivers in California to operate their vehicles more safely and incented insurers to improve their claims practices and anti-fraud efforts. Prop 103 may well have had some positive effects in this regard. However, the simpler and more direct hypothesis is that other factors are more at play. These include California's first-mover status in primary enforcement of seat-belt laws, stronger drunk driving enforcement and the California Supreme Court's Moradi decision, just before the passage of Prop 103, that put a stop to future third party bad faith lawsuits, a problem that had burgeoned in the decade prior.

There are several elements of the CFA report that should cause the reader to be skeptical of its conclusions.

- While early in the CFA report Prop 103 is cited as containing nearly all of the features that would characterize an ideal system, in the latter pages of the CFA report one finds that many of the major features were never implemented fully or at all, having either been invalidated by the courts or downplayed by the Insurance Department.

- The 20% rate rollback mandate fell far short of full application since the courts found that the Fifth Amendment to the U.S. Constitution stood in the way of confiscatory state action.
- Premium and loss data have not been collected by ZIP Code.
- Territorial rating has not been banned as Prop 103 advocates intended and is as important as ever for insurer rate setting.
- The courts have prevented independent lawsuits against rates already approved by the Insurance Commissioner.
- Permanent rate making rules have not yet been adopted.
- The expected Insurance Department comprehensive buyer's guide for comparison shopping has not been developed.

- The linchpin belief in the report that a 20% good driver discount in Prop 103 has, itself, been a key factor in driving down auto loss costs is belied by the fact that while liability loss costs have fallen, physical damage losses have risen. This dynamic suggests that something happening in the liability side of the equation. We cannot easily conclude that California drivers have found a way to have accidents that hurt cars but not people. While the good driver discount may be helpful, it is far more likely that the main force in reducing liability costs has been the 180 degree turnaround in the opportunity for third party bad faith lawsuits that occurred with the 1988 California Supreme Court Moradi decision.

- The CFA report takes the position that since a number of other states have "Moradi" type laws but have seen their loss costs rise nonetheless, the Moradi decision does not distinguish California. The flaw in the analysis is that the Moradi laws in the other state were "preventive" measures undertaken before third party lawsuits were able to get off the ground to any degree while in California, the Moradi decision was "remedial," coming after nearly a decade of rapidly expanding court dockets. Other states recognized that the potential for third party bad faith lawsuits often prompted insurers to settle third party claims at levels higher than would otherwise have been the case. Thus, in California, the Moradi decision correlates with the point in time at which loss costs began to fall while in the other states, the loss cost increases at-tributable to this phenomenon were largely avoided.
- The CFA report tends to use statistical information in ways that should alert the reader to a heighten level of skepticism. A good

example is the attempt to establish a picture of unfairness in territorial rating by citing a 66% difference in liability insurance rates in central Los Angeles, a part of LA, compared to the average statewide premium outside the full City of Los Angeles. The CFA report on pages 16-17 reports that 93.5% of insured cars in central LA and 95.4% of insured cars elsewhere in California outside LA were claim free between 1982 and 1984, a difference of 1.9%. The report suggests that the 66% higher rate compared to statewide averages outside LA evidenced "redlining." The problem is that the 1.9% absolute difference in accident rate translates into a 41% higher accident rate in central LA than in the rest of the state outside LA (.019/.046=.41). The overall higher costs of medical care in LA and the propensity for litigation in LA could easily account for the additional portion of the rate difference.

- The CFA, which one would expect to decry as a systemic failure a ten-year sustained auto liability profit level double the national average (14.8% versus 7.25%), instead attributes the situation to a personal failure by the Insurance Commissioner to respond to CFA's entreaties for reduced profit levels. The CFA report does not seem to grasp the irony in its trumpeting as the best regulatory system in the country, a regime that yields such a result. Prop 103 seems to have frozen rates at extraordinarily high levels in 1989 and then operated to discourage voluntary rate reductions as loss costs fell. The prospect of being unable to raise rates if costs rose again must certainly have been considered by any rational insurance company management.

REGULATORY RESOURCE ALLOCATION

In the more than half-century since McCarran-Ferguson and the follow-on rate regulation legislation in the states, the entire structure and environment of the insurance industry has changed significantly. However, we have never really undertaken a comprehensive review of the framework of regulation established after World War II. In effect, many states continue to make regulatory resource allocations on the basis of a regulatory model that has not been seriously changed since that time. In many states substantial direct and indirect regulatory effort and funds are expended in order to regulate property-liability rates when there is little, if any research that suggests any benefit from doing so. And, there is much research to the contrary.

The states are on the front line of insurance regulation and the states have made major improvements in the past thirty years in solvency oversight and in the protection of consumers from unfair market conduct. Yet, much more could be done, especially if the resources devoted to the futile and unproductive exercise of rate regulation. An improved allocation of regulatory resources would include:

- Better pay for insurance department financial and actuarial examiners so states can compete for talent with private industry;
- Making insurance department consumer complaint management systems meet the best standards of private industry for high levels of consumer interaction and satisfaction;
- Increased anti-fraud prevention, detection and prosecution to limit auto and workers compensation fraud as well as the looting of insurance companies and the sale of fraudulent insurance products.
- Upgrading of the technological capacity of insurance regulators on a continuing basis so that regulators can be as technologically up-to-date as are insurers; and
- Investment in leveraging the Internet to help personal lines consumers shop and compare prices, services, products and financial strength.

Rate regulation seems to be an anachronism that sucks up resources for no good reason.

CHOICES FOR CONGRESS

Both the Illinois and California models deserve close attention and consideration. The terms and conditions and the results of the Illinois system seem clear and simple enough and have been in operation for thirty years (and nearly twenty years for workers compensation), weathering several underwriting cycles in all line of insurance. The California situation is far less clear. While current conditions can be compared empirically to those in 1988, the reasons for the change in conditions are subject to widely varying interpretations. These range from the belief that Prop 103 has largely been a non-event due to the ingrained competitive culture in the California insurance market and regulatory agency to the belief that Prop 103 itself has been the main reason for falling loss costs, even if profit levels are abnormally high.

The ultimate question, of course, is whether Congress wishes to maintain a system in which each state determines with total freedom where it will fit between the vast terrain between the Illinois model at one end and the New Jersey and Massachusetts model at the other. Or, should Congress provide guidance or requirements within which the states would address regulation of property-liability rates.

THE COUNCIL
of Insurance Agents + Brokers

Statement of The Council of Insurance Agents + Brokers

Submitted to the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
on
Insurance Product Approval: The Need for Modernization

Thursday, June 21, 2001

The Council of Insurance Agents and Brokers applauds Subcommittee Chairman Richard Baker for holding this hearing on the state-based system of insurance product approval. Chairman Baker and Chairman Oxley played integral roles in the 1999 enactment of financial services reform legislation, and we are heartened by their interest in seeing further modernization occur in the insurance regulatory system.

The Council's members represent firms that collectively sell more than 80 percent of all commercial property and casualty insurance in the country. While it is true that the biggest regulatory issue affecting agents and brokers is the licensing process, the NARAB provisions of the Gramm-Leach-Bliley Act will ultimately relieve that burden of duplicative, protectionist, state-by-state requirements. The subject of today's hearing – speed-to-market for insurance products – is the second biggest regulatory issue affecting Council members. We believe that the debate is now rightfully moving on to the larger questions surrounding the efficiency of state-based regulation for insurance companies. These issues were not addressed by Gramm-Leach-Bliley, and they threaten to severely damage the competitiveness of the U.S. insurance industry on a national basis and in the progressively global economy.

The enactment of financial services reform legislation in 1999 did much to bring the banking and securities industries into the modern economy, but it did not do the same for the insurance industry. Since the enactment of the McCarran-Ferguson Act in 1945, the U.S. economy has become more dependent on business transacted not only a national level, but also, increasingly, on an international level. Additionally, the phenomenal growth of the Internet and electronic commerce over the past several years have radically changed the way that all businesses compete. Consumers have come to expect an immediate response to their needs, and a business will lose customers if it cannot respond to their requests quickly enough.

Businesses that were once found only in a single state now have locations in several states and internationally. Consumers who once purchased goods and services only from local businesses now purchase these same goods and services from business located across the country and around the world. Insurers who once only insured individuals and businesses in a single state now write policies on a multi-state and multinational basis.

The Council of Insurance Agents + Brokers, 701 Pennsylvania Ave., NW, Suite 750, Washington, DC 20004
Phone: 202/783-4400; Fax: 202/783-4410; Internet: www.ciab.com
Contact: Joel Wood, Senior Vice President, Government Affairs

Unfortunately, insurance laws have changed little over the past fifty years to accommodate the sweeping changes that have occurred in the U.S. economy and the U.S. insurance industry. By and large, commercial property and casualty insurers must still gain approval on a state-by-state basis for the products they sell and the rates they charge for those products. The state-by-state approval process causes delays in bringing new products to market, and adds administrative costs to each and every insurance product sold. Additionally, this regulatory stagnation threatens the ability of commercial agents and brokers and their partner insurers to be responsive to newly-developing risks and quickly-changing consumer needs, and decreases the economic efficiency of commercial insurers, agents and brokers.

The commercial insurance marketplace has changed dramatically over the past several decades to meet the constantly changing needs of businesses that operate on a multi-state and multinational basis. Council members sell primarily commercial property and casualty coverages that are oftentimes focused on meeting specific sets of business risks. Additionally, Council members play a large part in setting up specialty programs that appeal to specific niche markets. Many of the ideas for product innovations begin at the broker level, when brokers attempt to build insurance programs that meet specialized these customer needs and then bring those ideas to insurance companies.

The involvement of Council members in developing programs brings great value to the commercial insurance consumer. In most cases, commercial consumers would not be able to find these niche coverages at an affordable price. In some cases, commercial agents and brokers work with insurers to develop new coverages that address emerging risks encountered by commercial clients. For example, Council members have been at the forefront of developing new types of insurance policies to address several kinds of risks based on Internet transactions and new liabilities that have arisen from these transactions.

In today's fast-paced world, both commercial insurers and the agents and brokers who sell their products must have the ability to bring new and innovative insurance products to market quickly and in the most-cost efficient manner. Council members believe that market forces, and not regulatory fiat, should guide the development of products to fit our customers' specialized needs. However, the current system of insurance product rate and form approval significantly impedes our members' ability to offer their clients the new and innovative products that their clients want and need. This is not only bad for our members' businesses – it is bad for their clients' businesses as well.

Currently, an agent or broker who develops a specialty program or coverage must wait to market that program until that product has gained the approval of all the insurance regulatory jurisdictions in which the agent or broker wishes to sell the product. If an agent or broker wants to sell the product on a national basis, that means it must wait for the approval of 51 jurisdictions. Sometimes, the wait for this approval can be interminable – and fatal to the product's success.

For example, a number of large commercial agents and brokers, including some Council members, have formed a captive insurer to provide professional liability insurance for themselves. Recently, this captive incurred a large loss, and needed to make changes to its policy form. Because of the nature of the policy, the captive needed to get the approval of all fifty-one jurisdictions before the changes could take effect in each jurisdiction. It has taken more than two years for the captive to secure the necessary regulatory approvals to the policy form. This type of regulatory delay is not acceptable if commercial insurers, agents and brokers are to remain competitive on a national and international basis.

The Council has consistently supported legislative efforts in individual states to streamline the commercial lines policy and form approval process. The Council also worked with the NAIC working group headed by Ohio Insurance Director Lee Covington that developed a set of proposals that promote operational efficiencies in the commercial property and casualty rate and form filing process, and that significantly streamline the rate and form approval process for most commercial insurance policies. The Council believes that the changes to the rate and form filing system proposed by Director Covington's working group will be the key to bringing new, innovative insurance products to market in a more timely fashion. For Council members who develop specialized insurance programs, these changes will be invaluable.

The Council believes that the reforms developed by Director Covington's working group, if fully implemented by all fifty states and the District of Columbia, will do much to begin to modernize the state-based insurance regulatory system. However, it is not clear that all states will do so. The adoption of these reforms by only a handful of states will do little to lessen the regulatory burden borne by commercial insurers, agents and brokers. While The Council remains hopeful that the states will continue to move down the path laid out by Director Covington's group, we also welcome further examination of speed-to-market issues by this Subcommittee.

The Council thanks Chairman Baker for the opportunity to offer these comments on the need for modernization in the insurance product approval process.

STATEMENT OF THE:

Independent Insurance Agents of America
National Association of Insurance and Financial Advisors
National Association of Professional Insurance Agents

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

June 21, 2001

STATEMENT OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, THE NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS, AND THE NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

June 19, 2001

This testimony is submitted on behalf of the Independent Insurance Agents of America (IIAA), the National Association of Insurance and Financial Advisors (NAIFA) (formerly NALU), and the National Association of Professional Insurance Agents (PIA) (collectively, "Insurance Agents"). IIAA, NAIFA, and PIA are non-profit trade associations that together represent over one million insurance agents and brokers and their employees throughout the United States. Their members are agencies and brokerages that work at all levels of the insurance market and sell a full range of insurance products and services. The Insurance Agents appreciate the opportunity to testify on a topic of great interest and critical importance to them – the entry into the marketplace of new insurance products, coverages and forms in an efficient, timely and responsive manner.

I. Introduction

It is essential in the new world of financial services regulation made possible by the Gramm-Leach-Bliley Act that all financial institutions have the same ability to offer their products in the marketplace. Unfortunately, the reality is that banking institutions and securities firms currently are able to market new and more innovative products and services immediately, while insurance companies are hampered by lengthy and complicated filings and approvals in all fifty states. As a result, insurance companies – and, derivatively, agents and brokers selling their products and services – are often at a competitive disadvantage compared to their counterparts in other financial services industries.

Today, insurance rates and policy forms are subject to some form of regulatory review in nearly every State, and the manner in which rates and forms are approved and otherwise regulated can differ dramatically from State to State and from one insurance line to the next. While most insurance codes provide that policy rates shall not be inadequate, excessive, or unfairly discriminatory, and that policy forms must comply with state laws, promote fairness, and be in the public interest, there are a multitude of ways in which States currently regulate rates and forms. These systems include prior approval, flex rating, file and use, use and file, competitive rating, and self-certification. These requirements are important because they not only affect the products and prices that can be implemented, but also the timing of product and rate changes in today's competitive and dynamic marketplace.

The current system, which may involve seeking approval for a new product or service in up to fifty-five different jurisdictions with different standards, is too often inefficient, paper intensive, time-consuming, arbitrary, and inconsistent with the advance of technology and the regulatory reforms made in other industries. It often takes two years or more to obtain regulatory approval to bring new products to market on a national basis. Cumbersome inefficiencies create opportunity costs, and the regulatory regime in many States is likely responsible for driving many consumers into alternative market mechanisms. As a result, the costs of insurance regulation are exceeding what is necessary to protect the public, particularly in the area of commercial insurance. In order to keep insurers competitive with other financial services entities and maximize consumer choice in terms of the range of products available to them, a change is needed. The Insurance Agents are committed to finding a solution that strikes a balance between timely and quality reviews and appropriate consumer protections.

II. Key Elements of the Solution

The solution to the current speed to market problem for insurers necessarily requires a more efficient state-based oversight process. Efficiency barriers exist in many States, regardless of the type of filing process that the State currently uses. A solution to the speed to market problem ultimately will involve each State's consideration and implementation of the following principles.

A. Review and Elimination of Unnecessary Requirements

The States should be encouraged to review their current regulatory requirements to identify regulations that do not offer meaningful protections to consumers or add value to the business of insurance. Regulations that do not serve these purposes should be eliminated. The Insurance Agents believe that significant improvements can be achieved through a careful review and subsequent streamlining of the overall process, as well as elimination of some state regulatory requirements.

A State's review should be designed to ensure that product approvals are occurring expeditiously – regardless of the rate and policy form filing requirements applicable in that State. As part of this review, States also should eliminate "desk drawer rules" – or department policies or conventions that are not based on state law or regulation. Generally, these rules thwart transparency and inhibit the efficient review of new products. Desk drawer rules that relate to or support regulatory requirements should be exposed so insurers are able to submit complete filings.

States should also review whether formal approval is even necessary for all products and forms. There may be instances – particularly in the commercial lines context – where less restrictive review systems (*i.e.,* file-and-use, use-and-file, and informational filing) are sufficient to protect consumers. The Insurance Agents also recognize that open competition may be an effective way to set rates and prices, provided that a particular market is truly competitive. The Insurance Agents support open or competitive rating in the commercial lines context.

B. Quicker Response Time for Filings

One of the most significant impediments to successful product launches is a slow response to the filing. Thus, any solution to the speed to market problem will involve standards requiring States to respond to approval requests in a more timely fashion. It is not uncommon for a company to file a new product for approval but not hear back about its application for a significant period of time, requiring them to once again formally ask for the Department's disposition. This can be a significant problem in States where approval is required before a product can enter the marketplace. States should be required to act promptly on filings and reduce the amount of information required on a carrier's individual filing.

Other options to consider in terms of improving response time include a single point of filing for new products, a "fast-track" filing system for form filings or flexible rating systems that include non-substantive changes, or a self-certification process for certain types of products. In a single point of filing regime, approval of the product by the reviewing State within a specified period of time would enable a company to use the product in multiple states. This type of system could be used for all product lines, or just those products – like life and health products – that tend to be more homogenous and offered on a nationwide basis.

A "fast-track" filing option could be implemented regardless of the type of filing system employed, although its application would be limited to certain types of products. Similarly, a self-certification process may be employed with respect to a limited range of products or situations. For example, insurers making filings that have previously been approved by a regulator would be appropriate for self-certification. Even where fast track or self-certification approval processes are employed, however, retrospective enforcement ability should be preserved.

C. Identification of Uniform Standards for Filing and Review

The Insurance Agents support the identification and adoption of uniform standards among the States for product and rate filings and streamlined approval processes. This includes, but is not limited to, the development of standardized submission forms.

States also should be encouraged to identify and publicize filing checklists that contain guidelines or standards for filing. Two sets of checklists are required, one for carrier submissions and one for regulators' review. The development of filing submission checklists will assist insurers in submitting complete filings and will in turn decrease the amount of time required by regulators to review filings. Additionally, regulatory review checklists will help ensure that regulators' deviations from statutory and regulatory review requirements only occur in unique situations. Both should be available to carriers submitting filings so that they may fully appreciate the process and can be guided accordingly.

D. More Transparent Review Process

Another practice that sometimes contributes to the speed to market problem is the denial of approval applications without sufficiently clear articulated reasons. Such denials may sometimes occur even when the standards for approval are clear. If a State denies a filing, it should be required to fully and clearly articulate the reasons for the denial, so that a company can identify potential problems with their filings and correct any flaws. With increased transparency, fewer applications will be denied based on unofficial "desk drawer rules" or for arbitrary reasons, both of which should be prohibited.

E. Greater Use of Technology

Just as insurers are changing their business practices to make better use of technological advances, so should state insurance departments. States should consider implementing filing procedures that make greater use of telephones, faxes, and e-mail in order to increase the filing efficiency and reduce the amount of time it takes to have simple questions answered. States also should consider posting sample forms or filing checklists on their web sites for companies to use when submitting product rate filings. In addition, States should be encouraged to provide reports on their web sites summarizing why filings were disapproved. This practice also will increase transparency of the review process and assist insurers in identifying and correcting any errors.

III. The NAIC Initiative

The National Association of Insurance Commissioners (NAIC) has called for its own review of how States regulate the development of insurance products and their introduction into the marketplace. It has established a subgroup to develop a series of recommendations aimed at further improving state-based filing and review procedures. The NAIC's Speed to Market Working Group has been considering the manner in which States regulate policy forms and rates, and has identified numerous ways to improve the multi-state system.

The Insurance Agents support the approach that the NAIC has taken in addressing the speed to market problem and, in particular, its incorporation of many of the principles that the Insurance Agents have addressed above. The Insurance Agents further recognize that the NAIC is tackling this issue even though it is not compelled to do so by any federal mandate, and we commend the organization for making this a priority.

In furtherance of this initiative, the NAIC recently unveiled a proposal to create the Coordinated Advertising, Rate, and Form Review Authority (CARFRA). CARFRA is a pilot program in which the Departments of Insurance of ten States – Alabama, Arkansas, Indiana, Maine, Michigan, New York, Ohio, Oregon, Pennsylvania, and Texas – are participating. The goals of the program are to identify best practices, including those which may be legislatively implemented in the individual States for greater uniformity of filing and review procedures, and to increase the efficiencies, expertise, and transparency applied to the review process.

Because the plan to establish CARFRA was only recently released, there are many issues and questions that still must be addressed. Although CARFRA promises to foster greater uniformity and consistency in the filing process, many States have been reluctant to abandon their established practices. Thus, while the NAIC Speed to Market Working Group has adopted initial national standards for use in the limited launch of CARFRA, there are numerous individual "state deviations" to these standards. Unless these deviations are eliminated, when CARFRA is expanded to include more States and additional insurance lines, the number of deviations will increase exponentially and defeat the purpose of the initiative. This is especially true considering that the CARFRA pilot program has focused only on life and health products, which are more homogenous in nature than, for example, property and casualty products, to which an even wider range of state statutory and regulatory requirements apply.

The chairs of the NAIC working group are aware of these problems and are attempting to deal with the state deviations. Ultimately, CARFRA may offer a viable mechanism for coordinating and standardizing the rate and form approval process. The Insurance Agents support the efforts of NAIC to address the speed to market issue, and they will continue to work with the NAIC to improve the state system of insurance regulation in this area and others.

IV. Conclusion

The Insurance Agents are committed to finding an acceptable solution to the speed to market issue that balances the demands of competition, free enterprise and product innovation with consumer protection. A successful effort will begin with States reviewing and revising their internal procedures, laws and regulations to ensure that new products, coverages, forms, and plans can enter the marketplace in an efficient, timely, and responsive manner. The Insurance Agents are hopeful that such efforts will bring about enhancements to the review process, allow the industry to introduce products more efficiently, and permit insurers and agents to be more responsive to the needs of the public.