Testimony of the
National Association of Insurance Commissioners

Before the
Committee on Banking, Housing and Urban Affairs
United States Senate

Regarding:
"State of the Insurance Industry: Examining the Current Regulatory and Oversight Structure"

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On behalf of

National Association of Insurance Commissioners

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Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to testify today. My name is Steven Goldman. I am the Banking and Insurance Commissioner for the State of New Jersey, and I am here today behalf on of the National Association of Insurance Commissioners (NAIC). I am pleased to be here to update the Committee on the current State-based structure of insurance supervision and on our ongoing, successful efforts to improve and strengthen that structure.

Having served as the front line of U.S. insurance regulation for over 150 years, State insurance officials have a record of consumer protection and industry oversight that is second to none. We take seriously our responsibility to ensure that the safety net of insurance is there when people need it most. We are a powerful advocate for insurance consumers and an objective regulator of the largest insurance market in the world, leveraging the strengths of local, accountable oversight with technology and collaboration to streamline regulatory efficiency. The current U.S. insurance regulatory scheme is strong, and our track record is regarded internationally as the benchmark by which other supervisory systems are measured.

State insurance regulation in 2008 builds on this effective legacy, but at the same time constantly evolves, innovates and improves to meet the needs of consumers and insurers. In my testimony today I will focus on State efforts to improve insurance regulation, and attempt to dispel notions that a dual regulatory system for insurance, like that of banks, is necessary or prudent. At the outset, we must make clear that any reforms to the system should start and end with the States. To the extent that Federal assistance is necessary, it should be targeted to improve the current system and not supplant a century and a half of successful and effective supervision.

States Oversee a Vibrant, Competitive Insurance Marketplace

In addition to successfully protecting consumers, State insurance officials have proven to be adept stewards of a vibrant, competitive insurance marketplace. The insurance industry in the United States has grown exponentially in recent decades in terms of the amount and variety of insurance products and the number of insurers. There are more than 7,660 domestic insurers currently operating in the United States, with more than 2,000 new companies formed since 1995.

Combined premiums now top $1.4 trillion. As a share of the U.S. economy, total insurance income grew from 7.4 percent of gross domestic product in 1960 to 11.9 percent in 2000. In 2005, while insurance companies were absorbing record losses, they were also making record profits. Profits and surplus have continued to increase each year since. Insurance company surplus is now over $500 billion for the first time ever.

Clearly, this is not an industry that has suffered under State insurance supervision. In light of the record profits just cited, one should look skeptically at claims by some in the industry that appropriate rate regulation is harming their ability to compete. In reality, State regulators' modernization efforts have led to a competitive, profitable market for insurers and lower costs for consumers.

Today, companies of various sizes sell a vast array of products across State and national boundaries, reflecting the growing national economy and diversity of buyer needs, and the demand for insurance protection and investment products. Industry changes caused regulatory institutions to evolve, and State supervisory evolution, in turn, has contributed to the development of the insurance industry. This has resulted in a nimble regulatory environment that clearly has served insurance consumers well.

Insurance Regulatory Modernization: A Dynamic Process

Insurance supervision in recent years has been subject to increasing external and internal forces, to which the States have responded. Fundamental changes in the structure and performance of the insurance industry have complicated the challenge. Insurance companies have become increasingly national and international in scope and have widened the boundaries of their operations. One constant, however, remains: the local nature of insurance markets and the perils consumers face.

Each State, and in some cases, even each zip code, represents a distinct market, with varying risks, products and prices. Tort laws, court systems, workers' compensation laws, and the perils for which individuals and businesses buy insurance differ widely from State to State. Critics of State insurance regulation somewhat disingenuously point to the fact that a consumer moving to a different State must obtain new insurance policies for auto, homeowners, etc.; however, that is a reflection of our nation's vast differences in geography, demographics, and risk, and is not a phenomenon that would change under a Federal regulatory scheme.

When State insurance markets are compared to other national insurance markets around the globe, the size and scope of those States' markets – and therefore the responsibility of State regulators – typically dwarfs the markets of whole nations. Four of the top ten and 26 of the top fifty insurance markets in the world are U.S. states. For example, Mr. Chairman, the insurance market in your home State of Connecticut is larger than the insurance markets in Brazil or Sweden. Likewise, the markets in California, New York and Florida are each larger than the markets in Canada, China or Spain, and the markets in Ohio and Michigan are each larger than the markets in India, Ireland or South Africa. Each of these markets demands a local, accountable and responsive regulator.

The States have enhanced the resources devoted to insurance supervision, and the NAIC through its members has played a central role in State efforts to strengthen and streamline oversight of the insurance industry. These are not one-time silver bullet solutions, but rather represent a dynamic, ongoing process that changes and evolves along with the business of insurance that we oversee. The modern system of State-based insurance supervision builds on over 150 years of State insurance commissioners acting as stewards of a healthy, vibrant insurance marketplace founded upon a bedrock of comprehensive policyholder and consumer protection. But it also demands that State insurance officials be ever vigilant to anticipate and respond to the changing needs of consumers, the industry and the modern marketplace.

Optional Federal Charter – A Misguided Solution

One of the questions underlying this hearing is what should be the role of the Federal government in regulating insurance. We can start by addressing what that role should not be. For over a decade, insurance industry lobbyists have called for the creation of a new Federal bureaucracy via an optional Federal charter ("OFC") that would create a dual system of oversight, similar to the banking system. This concept was a bad idea then, and the current climate of instability and insolvency in the banking sector illustrates that it is an even worse idea now.

The OFC concept is a thinly veiled attempt to unravel the consumer protections, solvency structure and oversight that have led to the largest and most successful insurance market in the world. It was less than ten years ago that Congress reaffirmed, through the passage of the

Gramm-Leach-Bliley Act, that the States are the appropriate regulators for the unique business of insurance, and indeed it was Congress that compelled the States to strengthen and tighten solvency standards in the wake of numerous insurance company insolvencies in the late 1980s. We heeded your concerns and have developed a single, national system of solvency oversight that has allowed the industry in recent years to benefit policyholders and shareholders alike, by sustaining and paying claims presented to them while earning record profits.

Some OFC proponents also argue for U.S. implementation of unfinished, untested solvency standards of foreign regulators in an effort to relax capital and surplus requirements. We are continually working with our foreign colleagues to review and consider the merits of their concepts, but it would be imprudent for us to abdicate our solvency responsibility to our foreign colleagues, particularly when the broader financial sector is struggling.

Avoid a Race to the Bottom – Keep Solvency Protections in Place

We would urge careful analysis of any proposal to achieve modernization of insurance supervision in the United States by applying global standards. Even well intended and seemingly benign "equivalence" standards can have a substantial adverse impact on existing State protections for insurance consumers.

The "Solvency II" directive currently under consideration by the European Union has been held up by some as the beacon of global insurance regulatory reform. We should be careful what we wish for. There is no question that the lower reserve requirements under Solvency II would be appealing to a large insurer. Less money in reserve means more to spend, perhaps on risky but potentially lucrative new ventures. But this type of thinking is exactly what got us into the recent subprime mess and the ongoing banking instability, and what led to the great banking and stock market crises of past years. If there is anything we have learned, it is that an industry hungry for profits does not always have the consumer's best interests at heart.

But on top of that, Solvency II is nowhere near ready to go into effect. Under the current timetable, the Directive is not scheduled to be implemented by the various member countries until 2012. Several smaller EU States have expressed reservations about its effect on their own insurance consumers. The Solvency II concept is far from a reality, even where it originated. Now is certainly not the time for the U.S. to jump onto the Solvency II bandwagon. Instead the

Federal government should be supporting State regulators who are carefully considering aspects of Solvency II and principles-based regulation for potential application within the State system of solvency regulation.

Systemic Risk – A Place for State/Federal Partnership

Earlier this spring, the U.S. Treasury Department released its "Blueprint for a Modernized Financial Regulatory Structure." While we disagree with the Department's ultimate solution for insurance regulation – namely, an optional Federal charter – we do believe that the report's recommendation for increased knowledge and expertise in insurance at the Federal level is a good one. For that reason, the NAIC has offered its conditional support for H.R. 5840, which would establish an Office of Insurance Information within the Department of the Treasury to gather data and advise the Secretary on key international and domestic insurance issues. We have stressed our willingness to continue working with the House Subcommittee that is currently shaping the legislative language, and have expressed our concern that the bill should not be expanded to more broadly preempt State regulatory authority or detrimentally affect our consumer and solvency protection functions.

We recognize that insurance is part of a far larger financial services picture. In the 21st Century, risk in one sector can easily affect others. The recent bond insurance crisis in the United States, and the subprime mortgage crisis now reverberating worldwide, are clear examples. We need a way to address systemic risk, and the NAIC believes that a Federal office utilizing the expertise and knowledge base of the State insurance regulatory system would be a positive step forward.

State Insurance Supervision Has Been Strong and Effective

State insurance supervision has a long history of aggressive consumer protection, and is well suited to the local nature of risk and the unique services offered by the insurance industry. State regulators live and work in the communities they serve, and can respond accordingly. When Hurricane Dolly came ashore last week as a Class Two storm, the Texas Department of Insurance was on the ground with several teams of specialized staff ready to assist policyholders in the affected areas. The Department utilized a Consumer Help Line to assist consumers with filing claims, contacting agents, or understanding coverage. It also issued several emergency bulletins to insurers addressing the situation and indicated that it is "inappropriate for insurers to re-rate, cancel, nonrenew, or refuse to provide coverage due solely to an individual's status as a victim or evacuee of Hurricane Dolly. Further, it is not reasonable to change policyholders' rating classifications or increase their insurance rates solely because they are a victim or evacuee of Hurricane Dolly." This kind of consumer-oriented local response is the hallmark of State insurance supervision, an asset that would be lost in any attempt to federalize oversight of insurance.

While State insurance commissioners are strong advocates for consumers, we also strive to provide a stable, efficient regulatory environment for insurers, reinsurers, producers and other industry participants. We work collectively, through the NAIC, to streamline oversight, stimulate competition and eliminate redundancies between the jurisdictions. These efforts are constantly evolving and we welcome the scrutiny of Congress to assist in finding ways to better serve consumers and the industry. Insurance regulation must constantly be reformed and improved, and while those efforts should always start at the State level, we would ask that Congress work collaboratively with us and our colleagues in the State legislatures to appropriately target efforts to strengthen the existing State system where areas necessitating Federal assistance are identified.

As an example of this commitment, we have worked with the producer community on legislation to streamline non-resident licensing, and we have offered guidance to improve legislation pending before this Committee that would simplify the tax collection and allocation of surplus lines, while implementing uniform eligibility standards for surplus lines carriers. We play an integral role in the development of Federal health insurance policy, establishing standards based on our expertise and experience. We have also held extensive discussions with the Securities and Exchange Commission on the issue of equity indexed annuities. We look forward to continuing to work with Congress on these important issues.

Reforms should start at the State level, and they have. While our critics use the sheer number of States as a false argument to imply redundancy, we would argue that we have made great strides to reduce those redundancies and harmonize supervision from State to State. The NAIC has undertaken a number of initiatives with State insurance regulators in recent years, which are set out in Appendix 1 of this testimony. We have been the face of regulatory reform, coupling an aggressive enforcement mindset with advanced techniques to protect American consumers in times of peril. My testimony will cover a number of major areas where we have taken the initiative and successfully strengthened the State insurance regulatory process, such as:

- Interstate Compact;
- Solvency oversight;
- Consumer assistance and education;
- Fraud detection;
- Turnaround on rate and form filings;
- Producer licensing;
- Company licensing; and
- Uniform transmittal of documents

Interstate Insurance Compact – Speed to Market

Some life insurance companies have petitioned Congress in recent years for a Federal regulator to increase their products' speed to market. They claim that having different standards from State to State is unnecessary for this coverage, and argue that the State by State approval process puts them at a competitive and costly disadvantage. We have not taken that criticism lightly.

Insurance regulators have worked successfully to bring more cost-effective and sound insurance products to the market more quickly. Central to this effort has been the Interstate Insurance Compact ("the Compact") for speed-to-market filing and regulatory review of life, annuities, long-term care and disability insurance products. The States have heard the call for a more competitive framework in the insurance sector, and have responded.

The Compact is a key, successful State-based initiative that modernizes insurance regulation to keep pace with global demands, while continuing to uphold strong consumer protections. Under the Compact, insurers may make one central filing under one set of rules, resulting in one approval in under sixty days that is valid in all Compact Member jurisdictions. This vital reform has allowed insurers to quickly bring new products to market nationally according to strong uniform product standards, while preserving a State's ability to address front-line problems related to claims settlement, consumer complaints, and unfair and deceptive trade practices.

States have overwhelmingly embraced the Compact, as to date 32 States and Puerto Rico have passed the necessary legislation to adopt it. This represents over one-half of U.S. nationwide premium volume. More States are expected to come on board in the near future, including my State of New Jersey, fifth in premium volume nationwide, which is currently considering membership. Other large States, such as New York and California, also are considering membership.

As a cooperative partnership between State regulators and legislators, the initial start-up success of the Compact has proven that the States are proactively meeting the challenges of the global marketplace without sacrificing direct responsiveness to consumers – the bedrock upon which the stability of the insurance sector has been based for over a century.

Solvency Oversight

Since 1989, when the NAIC adopted a solvency agenda designed to enhance the ability of State regulators to protect insurance consumers from the financial trauma of insurer insolvencies, State insurance departments have made continual improvements to protect their consumers. At the very core of those improvements is the NAIC's accreditation program, which requires each State to have numerous laws in place to further strengthen the solvency of the industry. Many of these laws are designed to increase regulators' ability to identify and take action on a company when the financial condition of that company has weakened to a point where conditions are potentially hazardous to the consumer. These laws are therefore all designed to be proactive in how the industry is regulated.

In an international arena currently pushing to have regulation be more principles-based, U.S. insurance regulators understand the need to balance such an approach with prudence. In fact, the prudent standards adopted years ago by insurance regulators have somewhat sheltered insurance companies from the woes of today's market situations, which have clearly resulted from inadequate regulation in the mortgage and securities industries. For example, the various investment holding limitations and disclosure requirements have limited the insurance industry's exposure to the instability in the debt and equity markets today and have also resulted in the industry maintaining higher levels of capital to withstand these types of market struggles.

Due to improvements made by State regulators, there has been a 65% reduction in insurer insolvencies since the late 1980s. Ultimately, these improvements have allowed regulators to identify more easily when insurers are potentially troubled and react more quickly to protect policyholders and consumers. At a minimum, the NAIC urges Congress not to create a system that will allow regulatory arbitrage of the very standards that State insurance regulators have created to protect consumers. An optional Federal charter would weaken the insurance markets and result in more systemic risk. The Federal government should learn from the actions taken by State insurance regulators to protect the solvency of insurance companies and use the State insurance regulatory systems as a blueprint for how consumers in other financial service industries can be protected.

Consumer Assistance and Education

With the many changes taking place in the financial services marketplace, consumer protection poses significant challenges to a regulator. State insurance regulators have risen to the challenge.

Insurance is a unique and complex product that is fundamentally different from other financial services, such as banking and securities. Unlike banking products, which provide individuals up-front credit to obtain a mortgage or make purchases, or securities, which offer investors a share of a tangible asset, insurance products require policyholders to pay premiums in exchange for a legal promise. Insurance is a financial guarantee to pay benefits, often years into the future, in the event of unexpected or unavoidable loss that can cripple the lives of individuals, families and businesses. The cost to insurers to provide those benefits is based on a number of factors, many of which are prospective assumptions, making it difficult for consumers to understand or anticipate a reasonable price. Unlike most banking and securities products, consumers are often *required* to purchase insurance both for personal financial responsibility and for economic stability for lenders, creditors and other individuals. Most consumers find themselves concerned with their insurance coverage, or lack thereof, only in times of crisis – such as illness, death, accident or catastrophe. State officials have responded quickly and fashioned effective remedies to respond to local conditions in the areas of claims handling, underwriting, pricing and market practices.

The NAIC has been proactive in ensuring that State insurance regulators have the very latest and best tools to educate consumers on important insurance issues. These have included outreach campaigns, public service announcements and media toolkits. With its landmark *Insure U – Get Smart about Insurance* public education program, (www.insureuonline.org), the NAIC has demonstrated its deep commitment to educating the public about insurance and consumer protection issues. Insure U's educational curriculum helps consumers evaluate insurance options to meet different life stage needs. Available in English and Spanish, the Insure U website covers basic information on the major types of insurance – life, health, auto and homeowners/renters insurance. It also offers tips for saving money and selecting coverage for young singles, young families, established families, seniors/empty nesters, domestic partners, single parents, grandparents raising grandchildren and members of the military.

Fraud Detection

In January 2005, the NAIC launched an online fraud reporting mechanism to allow consumers, employees, or others who suspect wrongdoing to report their suspicions anonymously to State enforcement authorities. Since business practices in one State may be connected to problems in other States, the system allows for focused fraud detection where problems arise. Continued regulatory collaboration avoids duplicative and excessive data requests that delay responses from the producer and insurer industries and hinder appropriate State regulatory action.

Turnaround on Rate and Form Filings

The NAIC's System for Electronic Rate and Form Filing ("SERFF") provides a single point of filing for insurance products. Insurers choosing to file electronically have experienced a considerably shorter turnaround time than was possible under the traditional paper filing process, which SERFF has effectively made obsolete. SERFF is currently being used by all fifty States, the District of Columbia, Puerto Rico and over 3,000 insurance companies.

Producer Licensing

By developing and utilizing electronic applications and databases, State insurance officials have created much greater efficiencies in licensing and appointing insurance producers in those States that require it. State insurance officials remain deeply committed to achieving greater uniformity in the producer licensing process.

We are currently working with the Independent Insurance Agents and Brokers of America (the "Big I") to craft final legislative language to amend H.R. 5611 in a way that is satisfactory to State regulators, insurance producers and consumers. The bill is designed to achieve the non-resident licensing uniformity goals of the 1999 Gramm-Leach-Bliley Act. We are close, and are confident that our negotiations will produce a measure that will move quickly to enactment.

We trust that these efforts demonstrate our commitment to work to achieve the best possible insurance regulatory system. Insurance consumers need to know that the agent or broker selling them insurance is properly licensed, and not a rogue who has slipped through the regulatory cracks in another State – which sadly was not always the case in the past. Producer licensing is an area that cries out for uniformity nationwide, and we are not averse to Federal government involvement to achieve such uniformity when consumer protection hangs in the balance.

Company Licensing

To simplify insurers' application process for State licenses to write insurance, the NAIC has developed an electronic system and support designed to help insurers navigate State-specific requirements and provide a single entry opportunity when filing in all jurisdictions. The uniform application system is being applied by all jurisdictions, and has greatly eased application requirements for companies wishing to write insurance in multiple jurisdictions. Using this streamlined licensing system in a collaborative effort to stem the recent crisis in the bond insurance industry, forty States approved Berkshire Hathaway Assurance Corporation's application in less than a month, a number that increased to 49 shortly thereafter.

Conclusion

The system of State insurance supervision in the United States has worked well and has continuously evolved for over 150 years. State regulators understand that protecting America's insurance consumers is our first responsibility. We also understand that commercial insurance markets have changed, and that modernization of State insurance standards and procedures is needed to facilitate more streamlined, harmonized and efficient regulatory compliance for insurers and producers.

The NAIC and its members – representing the citizens, taxpayers, and governments of all fifty States, the District of Columbia and U.S. territories – will continue to share our expertise with Congress on insurance issues having a national and global impact, and we welcome Congressional interest in our modernization efforts. We look forward to working with you to continue to modernize insurance regulation and protect consumers.

Thank you for this opportunity to address you, and I look forward to your questions.

Appendix 1:

State Insurance Regulatory Reform Efforts

Area of Reform	States Response	Status
Life Insurance – Speed-to-Market: Life companies want to get products approved under one set of rules and into the market quickly to keep pace with global demands and to compete with banks.	The Interstate Compact: Creates a single point of speed-to-market filing for life, annuity, long-term-care, and disability insurance. Products are approved by the Compact under Uniform Standards in under 60 days and can be rolled out in every participating State.	33 Jurisdictions have adopted the Compact to date: Alaska, Colorado, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, Pennsylvania, Puerto Rico, Rhode Island, South Carolina (1/1/09), Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.
Solvency Oversight and Accreditation Program	Dramatically enhanced statutory & regulatory authority over the last 15 years through the NAIC accreditation program to ensure strong, harmonized solvency oversight. All accredited States must pass numerous common laws/rules to ensure consistency nationwide.	49 States are now accredited by the NAIC. Reforms have led to a 65 % reduction in insurer insolvencies. Investment holding limitations and disclosure requirements have limited the insurance industry's exposure to the instability in the debt and equity markets today. Standardized accounting and reporting allow for comparability and advanced financial analysis techniques to identify potentially troubled insurers at an earlier date.
Consumer Assistance & Education	Establishment of proactive consumer education program: www.insureuonline.org Bilingual advice about life, health, auto, and homeowners/renters ins. Assistance for families, seniors, military service-members, singles, & domestic partners	Over 850 million impressions since the launch in March of 2006. The program won the American Society of Association Executives' Award of Excellence and was a finalist for a 2007 SABRE Award.
Fraud Detection	Developed online fraud reporting mechanism to allow for interstate coordination Minimized industry data requests & increased collaboration	System has allowed for focused fraud detection where problems arise. Continued regulatory collaboration avoids duplicative and excessive data requests that delay responses from the producer and insurer industries and hinder appropriate State regulatory action.
Rate Form & Filing	NAIC developed the System for Electronic Rate and Form	Used by 50 States, D.C., Puerto Rico, and 3000+ insurance companies and third

	Filing (SERFF). SERFF offers a decentralized point-to-point, web-based electronic filing system. The system is designed to improve the efficiency of the rate and form filing and approval process and to reduce the time and cost involved in making regulatory filings.	parties. • 2001 – 3,694 Filings • 2002 – 25,528 Filings • 2003 – 76,932 Filings • 2004 – 143,818 Filings • 2005 – 183,362 Filings • 2006 – 269,101 Filings • 2007 – 381,377 Filings
Producer Licensing	Conducted nationwide on-site State producer licensing assessment to evaluate State practices for resident and non-resident licensing. Worked with interested parties and Congress on legislation to improve non-resident licensing.	State regulators are committed to non-resident producer licensing reciprocity in all States.
Company Licensing	NAIC established the Uniform Certificate of Authority Application, an electronic system and support designed to help insurers navigate State-specific requirements and provide a single entry opportunity when filing in all jurisdictions	Using the UCAA, Berkshire Hathaway was licensed by 49 States in less than 3 months.