Independent Insurance Agents
& Brokers of America, Inc.

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

BEFORE THE

U.S. SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

July 29, 2008

Good morning Chairman Dodd, Ranking Member Shelby, and Members of the Committee. My name is Tom Minkler, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA). Thank you for the opportunity to provide our association's perspective on insurance regulatory reform. I am currently Chairman of the IIABA Government Affairs Committee and was recently elected to IIABA's Executive Committee. I am also President of Clark Mortenson, a New Hampshire-based independent agency with 51 employees that offers a broad array of insurance products to consumers and commercial clients across the country.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a network of more than 300,000 agents, brokers, and employees nationwide. IIABA represents small, medium, and large businesses that offer consumers a choice of policies from a variety of insurance companies. Independent agents and brokers offer a broad range of personal and commercial insurance products.

Introduction

From the beginning of the insurance business in this country, states have carried out the essential task of regulating the insurance marketplace to protect consumers. State insurance regulators have done an excellent job of ensuring that insurance consumers, both individuals and businesses, receive the insurance coverage they need. Unlike some federal regulators of other financial industries, state regulators also have done an excellent job in the area of financial and solvency regulation, which ensures that companies meet their obligations to consumers. However, some inefficiencies do exist in the state-based system and it has become clear that specific areas in the current insurance regulatory system should be reformed and modernized. When considering such limited and targeted reform, we must remember that during the recent turmoil in various sectors of the financial services industry, the insurance industry has remained healthy and stable. Unlike other financial services markets, there is no "crisis" in the insurance market that necessitates a risky, massive overhaul of the current regulatory system. Therefore, when considering any reform, we must recognize, and we ignore at the marketplace's peril, that the current system does have great strengths – particularly in the areas of consumer protection and solvency regulation.

IIABA supports state regulation of insurance and we oppose the imposition of a pervasive federal regulation scheme. Yet despite our historic and longstanding support of state regulation, we believe that Congress has a vital role to play in helping to modernize the state regulatory system and overcome the obstacles to reform that currently exist. Through targeted federal legislation in areas such as surplus lines and agent licensing, the state-based system can be streamlined and modernized without taking the drastic step of creating a new federal agency. Additionally, such a targeted approach would not risk seriously disrupting a stable insurance marketplace and displacing the components of state regulation that work well as could occur under proposals for "optional" federal regulation.

To explain the rationale for our support of targeted legislation to achieve insurance regulation reform and our opposition to federal regulation and its potential to unsettle the insurance market, I will first offer an overview of both the positive and negative elements of the current insurance regulatory system. I will then provide a more complete explanation of the approach that we believe offers the most appropriate vehicle to modernize and improve the state-based regulatory system, including a proposal to reform insurance agent licensing. I will then outline the reasons for our strong opposition to measures to create an "optional" federal charter for insurance.

<u>The Current State of Insurance Regulation</u>

The current state insurance regulatory framework began in 1851 when my home state of New Hampshire appointed the first insurance commissioner. Insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved, and state regulatory personnel now number approximately thirteen thousand individuals. As recently as

the 1999 Gramm-Leach-Bliley Act (GLBA), Congress reaffirmed its confidence in state insurance regulation. Specifically, Title III of GLBA unequivocally provides that "[t]he insurance activities of any person (including a national bank exercising its powers to act as agent . . .) shall be functionally regulated by the states," subject only to certain exceptions that are intended to prevent a state from thereby frustrating the affiliation policy adopted in GLBA. The GLBA provisions collectively ensure that state insurance regulators retain regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. These mandates are intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Benefit of State Regulation: Consumer Protection

Most observers agree that state regulation works effectively to protect consumers, largely because state officials are best-positioned to be responsive to the needs of the local marketplace and local consumers. Unlike most other financial products, which are highly commoditized, the purchaser of an insurance policy enters into a complex contractual relationship with a contingent promise of future performance. Therefore, the consumer will not be able to determine fully the value of the product purchased until after a claim is presented – when it is too late to decide that a different insurer or a different product might have been a better choice. When an insured event does occur, consumers often face many challenging issues and perplexing questions; as a result, they must have quick and efficient resolution of any problems. In these circumstances, a local telephone call to the state insurance regulator works better than a call to an 800 number at a federal call center.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each state, and the policies themselves are contracts written and interpreted under the laws of each state. Consequently, the constitutions and statute books of every state are thick with language laying out the rights and responsibilities of insurers, agents, policyholders, and claimants. State courts have more than 100 years of experience interpreting and applying these state laws and judgments. The diversity of underlying state reparations laws, varying consumer needs from one region to another, and differing public expectations about the proper role of insurance regulation require local officials "on the beat."

Benefit of State Regulation: Solvency Regulation

Protecting policyholders against excessive insurer insolvency risk is one of the primary goals of state insurance regulation. If insurers do not remain solvent, they cannot meet their obligations to pay claims. State insurance regulation uniformly gets very high marks for the financial regulation of insurance underwriters. State regulators protect policyholders' interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs. The states, through the National Association of Insurance Commissioners (NAIC), have developed an effective accreditation system for financial regulation that is built on the concept of domiciliary deference (the state where the insurer is domiciled takes the lead role). When insolvencies do occur, a state safety net is employed: the state guaranty fund system. Proposals such as an "optional" federal charter to separate solvency regulation and state guaranty fund protection are impracticable and would be detrimental for insurance consumers.

Targeted Insurance Regulatory Reform

While the existing system does have many benefits, at times it can be slow and inefficient with divergent laws and regulations in some areas that may add unnecessary expense. These criticisms are accurate, and there is a need for a common-sense solution. While IIABA does continue to strongly support the state system, we don't believe that the states will be able to resolve their problems on their own. We believe that focused congressional action is necessary to help reform the state regulatory system and that two overarching principles should guide any such efforts in this regard. First, Congress should attempt to fix only those components of the state system that are broken. Second, no actions should be taken that in any way jeopardize the protection of the insurance consumer, which is the fundamental objective of state insurance regulation and of paramount importance to IIABA and its members. IIABA believes that effective solvency regulation and a disciplined guaranty system that does not require the potential support of federal tax dollars are essential to such protection.

The best method for addressing the deficiencies in the current system is a pragmatic, middle-ground approach that utilizes targeted legislation or federal legislative "tools" to establish greater interstate consistency in key areas and to streamline the often redundant oversight that exists today at the state level. By using targeted and limited federal legislation on an as-needed basis to overcome the structural impediments to reform at the state level, we can improve rather than dismantle or grievously injure the current state-based system and in the process produce a more efficient and effective regulatory framework. Rather than employ a one-size-fits-all regulatory approach that could unsettle the market, this can be accomplished through enactment of legislation dealing with particular aspects of insurance regulation in most need of reform, where bipartisan consensus can be established. Such an approach would not jeopardize or

undermine the knowledge, skills, and experience that state regulators have developed over decades.

While IIABA believes such a proposal or series of proposals must modernize those areas where existing requirements or procedures are outdated, it is important to ensure that this is done without displacing the components of the current system that work well. In this way, we can assure that insurance regulation will continue to be grounded on the proven expertise of state regulators at the local level and not subjected to the risky proposition of unproven federal insurance regulation. Targeted federal legislation addresses limited aspects of state insurance regulation only where uniformity and greater consistency is truly necessary and is the least intrusive option. Unlike other ideas, such as an "optional" federal charter, this approach does not threaten to remove a substantial portion of the insurance industry from state supervision.

Agent Licensing Reform

The most serious regulatory challenges facing insurance producers (agents and brokers) are the redundant, costly, and sometimes contradictory requirements that arise when seeking licenses on a multi-state basis, and the root cause of these problems is the failure of many states to issue licenses on a truly reciprocal basis. State law requires insurance agents and brokers to be licensed in every jurisdiction in which they conduct business, which forces most producers today to comply with varying and inconsistent standards and duplicative licensing processes. These requirements are costly, burdensome, and time consuming, and they hinder the ability of insurance agents and brokers to effectively address the needs of consumers. In fact, the current licensing system is so complex and confusing for our members that many are forced to retain

expensive consultants or vendors in order to achieve compliance with the requirements of every state in which they operate.

Some observers of our industry mistakenly believe that most insurance agents operate only within the borders of the state in which they are physically located and that the problems associated with the current licensing system only affect the nation's largest insurance providers. The reality is that the marketplace has changed in recent decades, and the average independent insurance agency today operates in more than eight jurisdictions. There are certainly agencies that have elected to remain small and perhaps only service the needs of clients in one or two states, but that is no longer the norm. Our largest members operate in all 50 states, and it is increasingly common for small and mid-sized agencies to be licensed in 25-50 jurisdictions as well. For smaller businesses, which lack the staff and resources of larger competitors, the exorbitant cost and unnecessary complexity of licensing is especially burdensome.

Congress recognized the need to reform the industry's multi-state licensing system back in 1999, when it incorporated a National Association of Registered Agents and Brokers (NARAB) subtitle into GLBA. GLBA did not provide for the immediate establishment of NARAB and instead included a series of "act or else" provisions that encouraged the states to reinvent and simplify the licensing process. In order to forestall the creation of NARAB, at least a majority of states (interpreted to be 29 jurisdictions) were required to license nonresidents on a reciprocal basis. In short, GLBA required compliant states to accept the licensing process of a producer's home state as adequate and complete, and no additional paperwork or requirements would be required (no matter how trivial or important they may seem). The NAIC maintains that approximately 45 states have met the reciprocity standard established in the GLBA, but the suggestion that so many states license nonresidents on a truly reciprocal basis would come as a

surprise to the real-world practitioners who must regularly comply with the extra hurdles and requirements imposed by states. Unfortunately, it has become apparent that true reciprocity remains elusive.

Our diverse membership of small and large agents and brokers hoped meaningful and tangible reform was imminent following GLBA's passage and the subsequent enactment of at least elements of the NAIC's Producer Licensing Model Act (PLMA) by most jurisdictions, but we are still awaiting the promised benefits almost nine years later. Although Congress's action did spur some activity and modest state-level improvements, insurance producers have been disappointed by the lack of meaningful progress that has been made over the last decade.

To rectify this problem, IIABA strongly supports federal legislation that would update and give full and immediate effect to the NARAB approach of GLBA. Such a measure would streamline nonresident insurance agent licensing but would be deferential to states' rights as day-to-day state insurance statutes and regulations, such as laws regarding consumer protection, would <u>not</u> be preempted. By employing the NARAB framework already passed by Congress and utilizing the experiences and insights obtained over recent years to modernize this concept, Congress can help policyholders by increasing marketplace competition and consumer choice through enabling insurance producers to more quickly and responsively serve the needs of consumers. Such reform would eliminate barriers faced by agents who operate in multiple states, establish licensing reciprocity, and create a one-stop facility for those producers who require nonresident licenses.

Federal legislation would establish NARAB as a private, non-profit entity that would be managed by an eleven-member board of directors comprised of state insurance regulators and private sector representatives. NARAB's simple and limited mission would be to serve as a

portal or central clearinghouse for nonresident license issuance and renewal. A NARAB member agent would identify the state(s) in which he/she sought the authority to operate, and NARAB would collect and remit the state licensing fees back to the appropriate jurisdiction(s). States would be prohibited from denying a nonresident license to any NARAB member who correctly completed the process and paid the fees.

In order to join NARAB, an insurance producer would have to be licensed in good standing in his/her home state, undergo a criminal background check (long a priority of state insurance regulators but currently required by less than 14 states), and satisfy independent membership criteria established by NARAB, which would include standards for personal qualifications, training and experience. NARAB also would establish continuing education requirements comparable to the requirements of a majority of the states as a condition of membership, and the term of membership would be two years.

The NARAB Reform Act, which was introduced in the House earlier this year, incorporates these principles and accomplishes the goal of agency licensing reform. This legislation, H.R. 5611 or "NARAB II," has broad industry and bipartisan congressional support and recently passed the House Financial Services Capital Markets Subcommittee. The bill ensures that any agent or broker who elects to become a member of NARAB will enjoy the benefits of true licensing reciprocity. It only addresses marketplace entry and leaves regulatory authority and marketplace oversight in the hands of state officials. Additionally, the NARAB Reform Act does not affect resident licensing requirements or producers who are satisfied with the current system. Again and most importantly, it does not displace state regulation and oversight of producers and does not preempt state consumer protection laws, but instead achieves

many of the public policy objectives that have been pursued by regulators. In recognition of this, the NAIC recently endorsed the NARAB Reform Act.

Surplus Lines Reform

IIABA also supports targeted legislation to apply single-state regulation and uniform standards to the nonadmitted (surplus lines) and reinsurance marketplaces. As with the admitted market, surplus lines agents and brokers engaging in transactions that involve multi-state risks currently must obtain and maintain general agent or broker licenses and surplus lines licenses in many if not every jurisdiction in which the exposures are located. Some states require that these agents and brokers obtain and maintain corporate licenses as well. This means that a surplus lines broker or agent could potentially be required to obtain and maintain up to 100 separate licenses in order to handle a single multi-state surplus lines transaction. Moreover, each state has different licensing requirements and renewal schedules. These duplicative licensing requirements cause administrative burdens which impede the ability of agents and brokers to effectively and efficiently service their customers' policies. Perhaps most importantly, these onerous licensing requirements create expenses which ultimately impact policyholders. The Nonadmitted Insurance and Reinsurance Reform Act alleviates the burdens of duplicative licensing requirements by relying on the insured's home state for licensing and encouraging states to participate in a national insurance producer database without diminishing the quality and expertise of the surplus lines insurance distribution channel.

Other Potential Targeted Reform Measures

An additional area ripe for targeted reform is the product approval process. For life products, federal legislation could build upon the progress made by the Interstate Insurance Product Regulation Commission (which now includes more than 30 jurisdictions) in the approval of life, disability, and long-term care products. For property/casualty products, targeted legislation could facilitate the establishment of a coordinated electronic system for nationwide single point of filing, common filing nomenclature to reduce unnecessary forms filings and deviations, eliminate all unpublished desk-drawer rules, and expedite review of forms through established and enforceable time deadlines. We also welcome targeted measures to establish a federal knowledge base with a role in international insurance matters, but without regulatory power, to help solve any purported global competitiveness concerns.

“Optional” Federal Charter

I would be remiss if I did not discuss briefly our strong opposition to another suggested method to achieve insurance regulatory reform – the proposal to create a parallel and duplicative federal system of regulation by providing for an “optional” federal charter (OFC) for insurance. We are very concerned about this proposal for full-blown “optional” federal regulation of the insurance industry and believe that it would not reform the current system but would supplant and eviscerate the state system of insurance regulation. We also fear that such an approach has the potential to negatively impact an industry that has been relatively unaffected by the recent crisis afflicting financial markets that are federally regulated.

Creating an industry-friendly “optional” regulator, as current OFC legislation provides, is at odds with one of the primary goals of insurance regulation, which is consumer protection. The

best characteristics of the current state system from the consumer perspective would be lost if some insurers were able to escape state regulation completely in favor of wholesale federal regulation. As insurance agents and brokers, we serve on the front lines and deal with our customers on a face-to-face basis. Currently, when my customers are having difficulties with claims or policies, it is very easy for me to contact a local official within the state insurance department to remedy any problems. If insurance regulation is shifted to the federal government, I would not be as effective in protecting my customers. I am very concerned that some federal bureaucrat will not be as responsive to a consumer's needs as the local cop on the beat – that is, the state insurance regulator.

This is because the federal regulatory model proposes to charge a distant federal regulator with implementation and enforcement. Such a distant federal regulator will be poorly positioned to respond to insurance consumer claims and concerns. As a consumer, personal or business, there would be confusion as to who regulates policies, the federal government or the state insurance commissioner, and how coverages apply. I could have a single client with several policies with one company regulated at the federal level, while at the same time having several other policies which are regulated at the state level. As an agent representing clients with policies regulated at the federal and state level, though, I would be forced into the federal system, even if I wanted to remain licensed only in my home state.

Even though it is commonly known as "optional," current federal legislative proposals to allow for such a federal insurance charter would <u>not</u> be at all optional for agents. Independent agents represent multiple companies, and, under this proposal, presumably some insurers would choose state regulation and others would choose federal regulation. In order to field questions and properly represent consumers, independent agents would have to know how to navigate both

state and federal systems, therefore making them subject to the federal regulation of insurance – meaning OFC would not in any way be optional for insurance producers. Even more importantly, "optional" federal charter would not be optional for insurance consumers. The insurance company, not the insurance consumer, would make that determination.

Again, IIABA believes that local insurance regulation works better for consumers and the state-based system ensures a level of responsiveness to consumers that could not be matched at the federal level. We are also concerned that OFC could create an environment in which the state system could not survive. OFC supporters believe that this proposal would create a healthy regulatory competition that will force state regulators to cooperate and be more receptive of the role of market forces. However, when state resources are siphoned off by a new federal bureaucracy, state insurance departments could be prevented from functioning at their current capacity and the ability of state insurance departments to function and approve products in a timely manner could be diminished. Thus, companies who continue to operate under the current system might be forced to become federally chartered. Additionally, much of state insurance fees and taxes are important sources of general use revenues used for state treasuries to fund various state proposals. In 2006, state governments received almost $2.75 billion from non-premium tax revenues (e.g. fees and assessments) and $13 billion in premium taxes. Current legislative proposals would fund a new federal regulator from industry fees and assessments, so examination and other fees for federally-regulated entities will certainly shift from state to federal coffers resulting in a significant loss of state revenue. There is no doubt that state revenue will decrease. We also believe that eventually a significant portion of state premium tax revenue will be lost to the federal government.

OFC supporters like to point to the dual banking system as an example of how regulatory competition could work, but this is an analogy that should raise many concerns. Primarily, there are fundamental differences between banking and insurance. The banking industry has no distribution force like the insurance industry, nothing similar to the claims process exists in the banking industry, and unlike many insurance products, banking products are commoditized and national in scope. Additionally, as we have seen in recent years with the Office of the Comptroller of the Currency's (OCC) forceful assertion of preemption, federal regulatory schemes can do grave harm to state consumer protection regulations. The recent crisis in certain sectors of the financial services industry also has shown us that federal regulation is not a panacea for market ills.

Current OFC proposals also would create a confusing patchwork of solvency/guaranty regulation, and would not replicate the significant structural (and prudential) improvements that were made in the banking model in the aftermath of the S&L failures and the banking crisis of the 1980s and 1990s, where the federal government had to bail out these struggling financial services markets. The dual structure proposed under current OFC measures could have disastrous implications for solvency regulation by largely bifurcating this key regulatory function from guaranty fund protection. OFC not only would hamstring the state system and not allow for time-tested and proven state financial regulation of insurers, but it also would require that the state system pay for any insurer insolvencies. In other words, the state system could not keep insurers from going insolvent on the front end, but would be required to backstop failed insurers on the back end. With the recent failures in federal financial oversight, this is a tremendous risk to take. In essence, these proposals would create an insurance version of the OCC without the integration of an FDIC into that supervisory system. Such proposals cherry-pick the features

from several of these federal banking laws to come up with a model which lacks the consumer protections found in any one of them, and which ignores the problems it would create for state insurers, guaranty funds, and their citizens.

Proponents of OFC assert that a federal regulator also is important if the U.S. is to remain a global financial services leader, in that an OFC would allow insurers to compete more freely and effectively. IIABA believes that any decline of U.S. capital markets competitiveness for insurance companies is due less to state-based regulation and more from other U.S. competitiveness concerns such as disparate tax treatment, diverse financial reporting standards, and the costs of excessive litigation. However, targeted proposals to provide for a federal base of insurance knowledge with authority on international matters and without regulatory power would allow these purported problems to be addressed without creating a new federal regulator.

In the end, IIABA feels that an OFC would disrupt the insurance market to the detriment of consumers while leading to a needless federal bureaucracy and unnecessarily infringing on states' rights. Unlike GLBA, which effectively empowers the states through uniform regulatory standards, an OFC weakens the states through the use of regulatory arbitrage. IIABA therefore believes that the risks of an OFC substantially outweigh any alleged benefits.

Conclusion

IIABA has long been a supporter of reforming the insurance marketplace. While GLBA reaffirmed state functional regulation of insurance, some continue to push for an "optional" federal charter. State regulators and legislators, many consumer groups, independent insurance agents and brokers, some life insurance companies, and many property-casualty companies are strongly opposed to federal regulation. The state system has proven that it best protects

consumers and can be modernized to work effectively and efficiently for the entire insurance marketplace with the right legislative pressure from Congress.

Targeted, federal legislation to improve the state-based system presents Members of Congress with a pragmatic, middle-ground solution that is achievable – something we can all work on together. The enactment of targeted federal legislation to address certain, clearly identified problems with state regulation is not a radical concept. We encourage the Senate Banking Committee to consider targeted reform, specifically in the area of agent licensing reciprocity. It is the only approach that can bring the marketplace together to achieve reform.