Independent Insurance Agents & Brokers of America, Inc.

STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE
September 22, 2004

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. My name is Tom Ahart, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA) and to provide our association's perspective on the role that Congress can play in enhancing and improving State insurance regulation. I am President of Ahart, Frinzi & Smith Insurance Agency, an independent agency based in Phillipsburg, New Jersey, and I served as president of IIABA from September 2001 to September 2002.

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 variety of insurance products – property, casualty, health, employee benefit plans and retirement products.

Introduction

At the outset, Chairman Shelby, I must note that IIABA applauds the Committee's interest in this issue as we have many challenges facing the State-based system of insurance regulation. It is our hope that this hearing will be the first step in what promises to be a comprehensive and ongoing process, and we hope we will have the opportunity to present our views at each and every stage of your deliberations on these crucial questions.

IIABA believes it is essential that all financial institutions be subject to efficient regulatory oversight and that they be able to bring new and more innovative products and services to market quickly to respond to rapidly evolving consumer demands. It is clear that there are inefficiencies existing today, and there is little doubt that the current State-based regulatory system should be reformed and modernized. At the same time however, the current system is exceedingly proficient at ensuring that insurance consumers – both individuals and businesses – receive the insurance coverage they need and that any claims they may experience are paid. These and other aspects of the State system are working well. The "optional" Federal charter concept proposed by some would displace these well-running components of State regulation and, in essence, "throw the baby out with the bathwater."

As we have for over 100 years, IIABA supports State regulation of insurance – for all participants and for all activities in the marketplace, and we oppose any form of Federal regulation – optional or otherwise. Yet despite this historic and longstanding support for State regulation, we are not confident that the State system will be able to resolve its problems on its own. That is why we feel that there is a vital legislative role for Congress to play in helping to reform the State regulatory system; however, such an effort need not replace or duplicate at the Federal level what is already in place at the State level. IIABA supports targeted, Federal legislation along the lines of the NARAB provisions of the Gramm-Leach-Bliley Act[1] (GLBA) to improve the State-based system.

To explain the rationale under-girding this approach, I will first offer an overview of both the positive and negative elements of the current insurance regulatory system. I will then outline our opposition to an optional Federal charter. I will then describe the NARAB provisions of GLBA that we feel can serve as a template for further reform. Finally, I will provide a more complete explanation of IIABA's support for the NARAB approach of targeted reforms already proven successful by this Committee.

The Current State of Insurance Regulation

From the beginning of the insurance business in this country, it is the States that have carried out the essential task of regulating the insurance marketplace to protect consumers. The current State insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851, and insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved. When a Supreme Court decision raised questions about the role of the authority of the States, Congress quickly adopted the McCarran-Ferguson Act[2] (McCarran-Ferguson) in 1945. That act, which was reaffirmed by Congress five years ago, declared that States should regulate the business of insurance and that the continued regulation of the insurance industry by the States was in the public's best interest.

[1] Previously known as the "Financial Services Modernization Act of 1999."
[2] McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§1011-1015 (1994))

GLBA expressly states that McCarran-Ferguson remains the law of the United States and further states that no person shall engage in the business of insurance in a State as principal or agent unless such person is licensed as required by the appropriate insurance regulator of such State. Title III also 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 which are intended to prevent a State from thereby frustrating the new affiliation policy adopted in GLBA. These provisions collectively ensured that State insurance regulators retained regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. These mandates were intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Most observers agree that State regulation has worked effectively to protect consumers, largely because State officials are positioned to be responsive to the needs of the local marketplace and local consumers. Unlike most other financial products, the purchaser of an insurance policy will not be able to fully determine 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 make a better choice. As a result, insurance is a product with which consumers have many issues and questions and if a problem arises they want to resolve it with a local call. During 2001, State insurance regulators handled approximately 3.6 million consumer inquiries and complaints. Today, State insurance departments employ approximately 13,000 individuals who draw on over a century-and-a-half of regulatory experience to protect insurance consumers.

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. When property, casualty, and life claims arise, their legitimacy and amounts must be determined according to individual State legal codes. Consequently, the constitutions and statue 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".

Protecting policyholders against excessive insurer insolvency risk is one of the primary goals of insurance regulation. If insurers do not remain solvent, they cannot meet their obligations to pay claims. State insurance regulation gets 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. The system has paid out over $11 billion to cover claims asserted against insolvent insurers since they were first created in the mid-1970s. States also supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase products and file claims.

Despite its many benefits, State insurance regulation it not without its share of problems. The shortcomings of State regulation of insurance fall into two primary categories—it simply takes too long to get a new insurance product to market, and there is unnecessary duplicative regulatory oversight in the licensing and post-licensure auditing process.

In many ways, the "speed-to-market" issue is the most pressing and the most vexing from both a consumer and an agent/broker perspective because we all want access to new and innovative products that respond to identified needs. 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. Such requirements are significant 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 55 different jurisdictions, is too often inefficient, paper intensive, time-consuming, and inconsistent with the advance of technology and regulatory reforms made in other industries. In order to maximize consumer choice in terms of the range of products available to them, changes and improvements are needed.

Similarly, insurers are required to be licensed in every State in which they offer insurance products, and the regulators in those States have an independent right to determine whether an insurer should be licensed, to audit its market-conduct practices, to review mergers and acquisitions, and to outline how the insurer should be governed. It is difficult to discern how the great cost of this duplicative regulatory oversight is justified.

<u>Federal Chartering</u>

There is growing consensus among observers, including State and Federal legislators, regulators, and the insurance marketplace – that insurance regulation needs to be updated and modernized. There is disagreement, however, about the most effective and appropriate way in which to obtain needed reforms. Some support pursuing reforms in the traditional manner, which is to seek legislative and regulatory improvements on an ad hoc basis in the various State capitals. A second approach, pursued by several international and large domestic companies, calls for the unprecedented establishment of full-blown Federal regulation of the insurance industry. This call for an optional Federal charter concerns me deeply.

Although the proposed optional Federal charter regulation might correct certain deficiencies, the cost is incredibly high. The new regulator would add to the overall regulatory infrastructure – especially for agents and brokers selling on behalf of both State and Federally regulated insurers – and undermine sound aspects of the current State regulatory regime. Agents could be required to obtain an additional license through a bureaucratic Federal agency. As an independent insurance agent, I write for multiple companies, and surely some companies would choose a Federal option while others would continue to be regulated at the State level, which could force me to get dually licensed.

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 my local company representative or 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 consumers, as I have serious reservations that some Federal bureaucrat on a 1-800 number will be as responsive to a consumer's needs as a local regulator. The Federal regulatory model proposes to charge a distant and likely highly politicized Federal regulator with implementation and enforcement. Such a distant Federal regulator may be completely unable to respond to insurance consumer claims concerns. As a consumer, personal or business, there would be confusion as to who regulates their policy, the Federal government or the State insurance commissioner. I could have a single client with several policies with one company that is regulated at the Federal level, while at the same time having several other policies which are regulated at the State level.

Finally, as I will discuss below, the "consensus" optional Federal charter proposal would require the State guaranty funds to be responsible for insurance companies whose solvency regulation is solely in the hands of a Federal regulator.

National Association of Registered Agents and Brokers (NARAB)

One of the most significant accomplishments of GLBA for the insurance marketplace was the NARAB Subtitle, which launched a producer licensing reform effort that continues today. Prior to the enactment of GLBA, each State managed its agent/broker licensing process in a distinct and independent manner, and there was virtually no consistency or reciprocity among the States. For agents and brokers, who increasingly operate in multiple jurisdictions, the financial and paperwork burdens associated with multi-State licensing compliance became overwhelming; and consumers suffered as duplicative and redundant regulatory requirements made it difficult for producers to be responsive to their needs. However, insurance producer licensing has improved dramatically over the last five years, and these changes are a direct result of Congress' decision to address these issues.

NARAB put the ball in the States' court by threatening the creation of a new national, NASD-style licensing entity – known as the National Association of Registered Agents and Brokers – if the States did not satisfy the licensing reform objectives articulated by Congress.

The creation of NARAB was only averted when a majority of the States and territories (interpreted to be 29 jurisdictions) achieved a specified level of licensing reciprocity within a three year period.

To their credit, the NAIC and most States took swift and unprecedented action in response to this "act-or-else" licensing provision. Nearly every State enacted new legislation that established licensing reciprocity among the States and instituted interstate uniformity in certain critical areas. According to the NAIC, at least 48 States have passed licensing reform legislation since the enactment of GLBA, and over 40 jurisdictions have been formally certified as meeting the NARAB mandates. There is no dispute that the NARAB provisions had their intended effect and initiated the move toward agent licensing modernization at the State level. Although more improvement is undoubtedly needed, the States have made significant progress in the five years since the passage of GLBA.

The success of the NARAB licensing provisions is a perfect example of what the Federal government and the States can accomplish in partnership and how Congress can assist the States to achieve much needed marketplace reforms. The NAIC and State policymakers had been trying to move toward reciprocal and uniform licensing for over a century, but little progress was made until Congress set a specific deadline and attached specific goals and repercussions. In fact, Congress set the bar at only a majority of the States and now all but a few have met the NARAB reciprocity standard. This success would not have occurred without targeted Federal legislation, or what some are now calling "Federal tools."

Some may argue that the bar was not set high enough -- because uniformity was not required and several States have not adopted the reciprocity standards -- but there is no arguing with the provision's effectiveness so far. There is certainly much more to do to get to full agent licensing reciprocity and the ultimate goal of licensing uniformity, but NARAB has set State insurance regulators on the right path, and Congress can now easily move the bar higher in follow-up legislation.

IIABA's Support for the NARAB Approach of Targeted Reforms

IIABA supports State regulation of insurance but feels that the system needs to be modernized to bring it into the 21st century. Despite our continued support for the State system, we question whether the States will be able to resolve their problems on their own. For the most part, State reforms must be made by statute, and State lawmakers inevitably face practical and political hurdles and collective action challenges in their pursuit of improvements on a national basis.

Therefore, IIABA believes that Congressional legislative action is necessary to help reform the State regulatory system. We propose 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 insurance regulation and of paramount importance to the IIABA as our members represent consumers in the insurance marketplace.

IIABA believes the best alternative for addressing the current deficiencies in the State-based regulatory system is a pragmatic, middle-ground approach that utilizes Federal legislative tools to foster a more uniform system and to streamline the regulatory oversight process at the State level. By using targeted and limited Federal legislation to overcome the structural impediments to reform at the State level, we can improve rather than replace the current State-based system and in the process promote a more efficient and effective regulatory framework.

Rather than employ a one-size-fits-all regulatory approach, a variety of legislative tools could be employed on an issue-by-issue basis to take into account the realities of today's increasingly global marketplace. There are only a handful of regulatory areas where uniformity and consistency are imperative, and Congress has the ability to address each of these core issues on a national basis in a single legislative act.

Congress's work in this area need not jeopardize or undermine the knowledge, skills, and experience that State regulators have developed over decades. While IIABA believes such a proposal 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.

Some optional Federal charter proponents argue that using targeted Federal legislation to improve State regulation is more intrusive on the State system than the optional Federal charter model. We strongly disagree. They would have you believe that the optional Federal charter proposals create a parallel universe of Federal chartered insurers but leave in place the State chartered system. This is not the case. In fact, to take one example, the so-called industry "consensus" Federal charter proposal would force the State guaranty funds to accept and backstop Federal chartered insurers – there is nothing "optional" about that. This would be an unprecedented intrusion on State solvency regulation. In the end, the State system would be responsible for insolvent insurers but could not regulate them to keep them from going insolvent.

This proposal turns the dual-banking model, which proponents profess to admire, on its head. It is as if the FDIC was turned into 50 State-managed individual deposit insurance corporations, and then these State funds were forced by Congress to insure both national banks and State chartered banks, but without the States having any supervisory authority over the national banks. The States are clearly left holding the bag under this proposal, which could lead to dysfunction in the insurance marketplace to the detriment of both consumers and companies.

In contrast, a NARAB approach is more deferential of States' rights and is designed to give the leverage to make State and NAIC-developed standards uniform across the nation. In each substantive area that Congress may choose to address in targeted legislation, a Federal "tool" could provide incentives for the States and the NAIC to develop standards and for the State legislatures or departments to adopt such models. The States could collectively develop the standards that are to become uniform. For example, the consensus choice of the majority of States in each area could become the uniform, required standards in all States. Preemption is only used as a last-resort in most cases. This preserves and builds upon the expertise of State regulation and leaves in place the substantial regulatory force which now protects consumer interests and insurer solvency at the State level. It is the least intrusive option, which unlike "optional" Federal chartering, does not threaten to remove a substantial portion of the insurance industry from State supervision and risk the creation of an unlevel playing field.

Unlike the creation of an entirely new regulatory structure, the enactment of targeted Federal legislation to address certain, clearly identified problems with State regulation is not a radical concept. The Senate Banking Committee and the House Financial Services Committee have already proven that this approach can work with the NARAB provisions of GLBA that we have already discussed. The IIABA believes the NARAB model can serve as a template for further reform of State insurance regulation. The leadership of the House Financial Services Committee has recently decided to take the NARAB approach of "targeted reform" after conducting a three year in-depth review of insurance regulation. We would recommend such an approach to the Senate Banking Committee as well, and look forward to working with the Committee as you continue your review of State insurance regulation and consider possible solutions to modernize the system.

Conclusion

IIABA has long been a supporter of reform of the insurance marketplace, working closely with the Senate and House in support of Gramm-Leach-Bliley, the Terrorism Risk Insurance Act of 2002 (TRIA), and more recently supporting an extension of TRIA and the developing consensus for State-based insurance modernization. While GLBA reaffirmed State functional regulation of insurance, some large insurers are now advocating for an "optional" Federal charter. State regulators and legislators, many consumer groups, independent insurance agents and brokers, some life insurance companies, and most property-casualty companies are strongly opposed to an optional Federal charter. In fact, the Property Casualty Insurers Association of America and the National Association of Mutual Insurance Companies which represent property-casualty insurers of all sizes oppose an optional Federal charter. 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 pressure from Congress.

Targeted, Federal legislation to improve the State-based system presents Members with a middle-ground solution that is achievable – something we can all work on together. This pragmatic approach would build on the success of the NARAB provisions in GLBA. Because of the Senate Banking Committee's work on NARAB, the vast majority of States have now implemented reciprocal agent licensing. This same approach can be used to get all States moving towards not only reciprocal but uniform agent licensing, as well as improving other areas of insurance regulation such as State market conduct oversight, company licensing, and product review. We encourage the Senate Banking Committee to take up the mantle of State based insurance reform and lead this effort. It is a proven a success with NARAB, and is the only solution that can bring the marketplace together to achieve reform.