Statement of

Albert R. Counselman, CPCU

President & CEO, Riggs, Counselman, Michaels & Downes, Inc.

Past Chairman, The Council of Insurance Agents + Brokers

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Regarding

Examination and Oversight of the Condition and Regulation of the Insurance Industry

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Good morning, Chairman Shelby, Ranking Member Sarbanes and members of the Senate Banking Committee. My name is Albert Counselman. I am President and CEO of Riggs, Counselman, Michaels and Downes in Baltimore, MD and past Chairman of The Council of Insurance Agents + Brokers ("The Council"). Thank you for giving me the opportunity to testify before the Committee today.

The Council represents the nation's largest, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place more than 80 percent – well over $90 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

Riggs, Counselman, Michaels and Downes (RCM&D) is the largest independent agency/brokerage firm in Maryland, with more than 250 employees. We are headquartered in

Baltimore, with offices in Washington and Richmond. Based on information reported by Business Insurance in their annual survey of firms, RCM&D is the 75th largest insurance/risk management agency in the U.S. Our clients range from large, multi-state employers in the Fortune 1000, to large and small hospitals, to mid-size and small businesses and individuals. We provide risk management, including risk control and claim management programs, commercial and personal insurance, self-insurance and employee benefit programs. We represent most of the largest and most well known insurers operating in the U.S. and many located overseas. We have been in business since 1885 and continue to be privately owned by individuals active in the operation of the business. Through our ownership and membership in organizations such as Assurex Global and Worldwide Brokerage Network, we service clients locally as well as throughout the U.S. and the globe.

Introduction

RCM&D and the members of the Council of Insurance Agents + Brokers commend you for holding this hearing on the condition and regulation of the insurance industry. Insurance regulatory reform, which is critical for the long-term health of the industry, is long overdue. Modernization of the insurance regulatory structure is an important element in maintaining a strong, vibrant insurance sector. We are very happy to see interest on both sides of Capitol Hill in addressing this issue.

A discussion of the condition of the insurance industry is not complete without addressing the risks posed by terrorism and the importance of the Terrorism Risk Insurance Act (TRIA). The need for federal action in the area of terrorism coverage is a clear example of the limits of State regulation. Although the State regulators worked diligently in the days and months after the September 11, 2001 terrorist attacks to help to bring stability to the insurance marketplace, it was abundantly clear that they did not have the capacity to act quickly to implement a uniform approach in every State to address the emergency. With the leadership of Senators Bennett and Dodd, and thanks to the hard work of the members of this Committee and others, TRIA was adopted to provide the backstop necessary to stabilize the insurance markets, and enable construction and real estate projects to go forward and critical, but vulnerable, infrastructure to be insured.

Now, as we look forward to the third and final year of TRIA's current life, the evidence is mounting that TRIA is effective and that purchase of terrorism coverage is increasing. It has also become evident, however, that the private marketplace will not be prepared to take on the full risk posed by potentially catastrophic terrorism losses by the time the law expires on December 31, 2005. Thus, it is imperative that TRIA be extended. The Council thanks Senators Bennett and Dodd for the leadership they have shown by introducing legislation that would accomplish just that. We urge this Committee to ensure that this important piece of legislation becomes law before you adjourn for the term.

I plan to address two main issues in my testimony today:

(i) The Terrorism Risk Insurance Act: extension of TRIA is critical for consumers/policyholders and for the insurance industry; and
(ii) Insurance regulatory reform: Notwithstanding some improvement in the last few years, there remain significant problems in the State insurance regulatory system; because the States cannot solve these problems on their own, congressional action will be necessary.

I. The Terrorism Risk Insurance Act: Extension of TRIA is critical for consumers/ policyholders and for the insurance industry.

TRIA has had a huge impact on the availability of insurance and the capacity of insurers to take on risk. The law has successfully brought stability to the private market for terrorism risk insurance, enabling all sectors of the economy to operate on a "business as usual" footing. Without the backstop, the economy could suffer significant damage as businesses pull back because the lack of insurance coverage makes them financially vulnerable. Under TRIA, insurers have the ability to offer terror coverage, thus allowing commercial activity to go forward without threatening the solvency of the parties involved.

TRIA's effect is felt in all corners of the country. Since its enactment, the availability of terrorism coverage has grown and premium prices have dropped. Statistics show that nearly one-half of all insureds now are purchasing terror coverage.

Earlier this year, Marsh, Inc., a member of The Council and one of the top insurance brokers in the U.S. and internationally, issued a report on the terrorism insurance marketplace based on data collected from its Global Broking centers across the country. The findings indicate that among 15 industries examined, the largest percentage of insureds buying terrorism insurance were in the energy industry. Media, food and beverage, habitational/hospitality, healthcare, and real estate were the other industries with the highest take-up rates. We believe one of the most significant aspects of these findings is that these industries operate across the country – they are not limited to one or two cities or geographic areas – and their products and services are used by all Americans. That is certainly true of the energy industry, which is a critical element of the national infrastructure. TRIA ensures that these industry sectors – which are terrorism targets because of their importance to the country, public safety and the economy – are able to secure the insurance coverage they need to operate.

Let me give you two specific examples of the importance of TRIA to my firm and our clients:

- One of our clients was building a downtown Baltimore apartment project – located near the Inner Harbor – and the lender required terrorism coverage for the builders risk and for the permanent property coverage. Because of the availability of TRIA, there were several insurers writing in that market. We were able to negotiate with various builders risk insurers, allowing us to provide multiple quotations promptly to the project owner. This gave the owner several competitive choices, rather than forcing the company to "take whatever they could get" in a non-competitive market – if they could get any coverage at all.

- Another client is a large financial services firm headquartered in a major city. Because of the existence of the TRIA backstop, a leading financial services insurance provider can offer multiple coverages to this insured, such as property, business income, workers' compensation and other lines. Without TRIA, however, the insurer would not be able to offer multiple-line coverages. For example, because our client has almost 1,000 employees in a downtown multi-story office tower, the insurer likely would not be able to offer the firm workers' compensation coverage. This would force the insured to seek coverage from an insurer that has the capacity to provide such coverage. If there were no insurers with available capacity, the insured may be forced to take significantly higher self-insured retention levels or go into a "State-managed workers' compensation pool." Insurers participating in these assigned-risk pools are "forced" to accept the workers' compensation risk.

When TRIA was enacted, the intent of Congress was to create a short-term federal backstop to allow insurance markets to gradually assume, and learn to price, terrorism risk – a risk that had previously been insured at no additional cost over the standard policy premium. As TRIA enters the third and last year of its original life-span, it is clear that the capacity of the private market to provide terrorism risk coverage will require more time to fully develop.

A comprehensive and accurate terrorism risk model is necessary for a private terrorism insurance and reinsurance market to take root; development of such a model, however, remains elusive. Risk modeling is a complex and difficult process. Terrorism risk modeling is all the more difficult because of the unique nature of the terrorist threat, the element of human intent and the limited historical precedents available to provide data for predicting future events.

Terrorism risk models cannot simply follow models for natural catastrophes, which do not involve human intent. To be effective, terrorism risk models need to be based upon:

- where attacks may occur;
- the nature and/or method of attack;
- the probability of a particular type of attack occurring at a specific location; and
- estimated damages that may be inflicted at the location.

In addition to the difficulty in modeling catastrophic terrorism risks, there are several other factors that make such risks uninsurable:

- the insurance sector does not have the capacity to handle truly catastrophic terrorism losses, so another huge terrorism event could financially ruin the commercial property and casualty industry;
- terrorism is an interdependent risk from which no one business or system can protect itself from failure on the part of others;
- information necessary to evaluate terrorism risk is often sensitive intelligence data held by the government;
- despite the modest amounts of reinsurance available for terrorism coverage, reinsurers will not be able to provide sufficient capacity to the market for terrorism insurance upon TRIA's expiration; and
- alternative financing mechanisms – such as alternative risk pools or catastrophe bonds – currently cannot generate sufficient capacity to deal with catastrophic terrorism risk.

Extension of TRIA must be made a priority. A recent study by Analysis Group, Inc., an economic research firm, says that TRIA helps strengthen the economy's performance by ensuring that commercial business and properties have terrorism risk coverage in place. The report indicates that failure to reauthorize TRIA could result in a $53 billion hit to the U.S. economy even without another terrorist attack. Without the backstop, insurers will reduce capacity for terrorism coverage and impose exclusions on current coverages. The study found that overall GNP would be reduced 0.4 percent without TRIA, total household income net worth would fall by $512 billion, and roughly 326,000 fewer jobs would be created.

The House is scheduled to consider extension of TRIA on September 29, one week from today. We urge you to make every effort to adopt legislation such as S. 2764 extending the program before you adjourn this fall.

II. Insurance regulatory reform: Notwithstanding some improvement in the last few years, there remain significant problems in the State insurance regulatory system; because the States cannot solve these problems on their own, congressional action will be necessary.

Although the State insurance regulators, through the National Association of Insurance Commissioners (NAIC), have attempted to institute regulatory reforms without federal involvement, the reality is that today's marketplace demands far more dramatic action than the States alone are able to provide. The pace of financial services convergence and globalization are far outstripping the pace of reform efforts by State regulators and legislatures. Competition and efficiency in the insurance industry lags behind other financial services sectors due to the regulatory inefficiencies and inconsistencies in the state insurance regulatory system, inefficiencies and inconsistencies that must be addressed if the insurance sector is going to be able to keep up with the pace of change in the rapidly-evolving global marketplace and thereby expand the insurance marketplace for the benefit of insurers, producers and consumers.

The Council regards itself as a pioneer within our industry with respect to regulatory modernization, though reform is a frustratingly long process. We formed our first internal committee to address the problems of interstate insurance producer licensing more than 60 years ago. Our efforts were finally rewarded with the enactment of the NARAB provisions of the Gramm-Leach-Bliley Act a few years ago – a first step on the road to insurance regulatory modernization.

While it is abundantly clear to Council members that the current system of State-by-State regulation is not working, we wanted to see a full, economic analysis of the alternatives for reform. To that end, The Council's Foundation for Agency Management Excellence (FAME) commissioned an independent study of the economic costs and benefits of the various proposals. Our study, entitled "Costs & Benefits of Future Regulatory Options for the U.S. Insurance Industry," provides an in-depth examination of the pros and cons of the regulatory options available for oversight of the business of insurance. A copy of the study is attached to my testimony. I hope it will serve as a useful tool as you consider insurance regulatory reforms.

A. Continuing Problems under the Current Regulatory System

Although the States have made some strides in recent years in simplification and streamlining regulatory requirements, almost all the concrete progress has been in the producer licensing area –

thanks to the enactment of the NARAB provisions included in the Gramm-Leach-Bliley Act (GLBA). NARAB-compliance notwithstanding, there remain several problem areas in the interstate licensing process that impose unnecessary costs on our members in terms of time and money. In addition, insurance companies face problems doing business on a multi-state basis, and recent efforts by the States to streamline rate and policy form approval processes have not proven to be very successful. The operation of and access to alternative markets – such as surplus lines and risk retention groups – is also hampered by unnecessarily cumbersome and duplicative regulatory requirements. These continuing problems with the State-by-State insurance regulatory process has lead us to the following conclusion: regulatory relief is needed, and it is needed now.

1. Producer Licensure: Welcome Improvements, but Incomplete Reform

The NARAB provisions included in GLBA required that at least 29 States enact either uniform agent and broker licensure laws or reciprocal laws permitting an agent or broker licensed in one State to be licensed in all other reciprocal States simply by demonstrating proof of licensure and submitting the requisite licensing fee.

After enactment of GLBA, the NAIC pledged not only to reach reciprocity, but ultimately to establish uniformity in producer licensing. The regulators amended the NAIC Producer Licensing Model Act (PLMA) to meet the NARAB reciprocity provisions, and their goal is to get the PLMA enacted in all licensing jurisdictions. As of today, forty-seven States have enacted some sort of licensing reform and the NAIC has now officially certified that a majority of states have met the NARAB reciprocity requirements, thereby averting creation of NARAB. This is a good effort, but the problems are in the details; there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions.

Although most of the States have enacted the entire PLMA, four States have enacted only the reciprocity portions of the model. Of the States that have enacted the entire PLMA, there are several that have deviated significantly from the model's original language. One State has enacted licensing reform that in no way resembles the PLMA. And two of the largest States in terms of insurance premiums written, Florida and California, have not enacted legislation designed to meet the NARAB reciprocity threshold at all.

The inefficiencies and inconsistencies that remain in producer licensing affect every insurer, every producer and every insurance consumer. As for my own firm, we hold 161 resident licenses in Maryland and Virginia, and 332 non-resident licenses across the country, up from 175 non-resident licenses in 1999. We not only had to secure initial licenses, but we face annual renewals for those nearly 500 licenses in 50+ jurisdictions, in addition to satisfying all the underlying requirements and post-licensure oversight. Progress in streamlining the producer licensing process has undeniably been made since GLBA's NARAB provisions were enacted in 1999, but these numbers – and, more critically, the regulatory and administrative burdens they represent – vividly demonstrate that the job is not yet finished. Most States retain a variety of individual requirements for licensing, and they all differ with respect to fees, fingerprinting, and certifications, among other requirements.

In addition to the lack of full reciprocity in licensing procedures for non-residents, the standards by which the States measure compliance with licensing requirements differ from State to State, as well. These include substantive requirements – pre-licensing education, continuing education and criminal background checks, for example – as well as administrative procedures such as agent appointment procedures and license tenure and renewal dates. While these may seem like small issues, they can easily turn into large problem for someone like me, who is licensed in all 51 jurisdictions: I must constantly renew licenses throughout the year, based upon the individual requirements in each State. In addition to the day-to-day difficulties the current set-up imposes, this inconsistent application of law among the States inhibits efforts to reach full reciprocity. Some States may be disinclined to license as a non-resident a producer whose home State has "inferior" licensing standards, even a State with similar or identical statutory language. In fact, several States that have failed to adopt compliant licensure reciprocity regimes claim that their refusal is based on this absence of uniform standards – thus implying that the standards of other States do not measure up.

A third major area in need of streamlining is the processing of license applications. Although a uniform electronic producer licensing application is now available for use in many States – arguably, the biggest improvement in years – several States, including Florida and South Carolina, do not use the common form, and in States that use the form there is no common response mechanism. Each state follows up on an application individually, which can be cumbersome and confusing. Our attempts to renew licenses in the District of Columbia last year offer an egregious example of this failure of forms and processing. Although renewal applications were submitted in April 2003, approval of the final renewal was not received until February of this year, after many attempts to follow-up.

Thus it is clear that, despite the revolutionary NARAB achievements, comprehensive reciprocity and uniformity in producer licensing laws remains elusive – and I am not sure that the NAIC and the States are capable of fully satisfying those goals. Indeed, until recently, the State of Florida completely barred non-residents from being licensed to sell surplus lines products to Florida residents or resident businesses. The State required non-resident agents and brokers who sold a policy of an admitted company to a Florida resident or resident business to pay a resident agent a mandated "countersignature fee" in order to complete that transaction. These practices have been terminated only because The Council filed a lawsuit and was granted summary judgment on its claims that these statutory requirements violated the constitutional rights of its members. Similarly, the United States Court for the District of Nevada ruled from the bench in The Council's favor on its challenge to analogous countersignature requirements in Nevada; the formal judgment has not yet been issued. West Virginia, facing a similar lawsuit initiated by The Council, repealed its countersignature requirements. The Council's suit challenging South Dakota's countersignature law is still pending.

2. Speed To Market

The State-by-State system of insurance regulation gives rise to problems outside the area of producer licensing that require immediate congressional attention, as well. Although these problems appear to affect insurance companies more than insurance producers, the unnecessary restraints imposed by the State-by-State regulatory system on insurers harm producers as much as companies because they negatively affect the availability and affordability of insurance, and, thus, our ability to place coverage for our clients.

My agency – like most Council members – sells and services primarily commercial property/casualty insurance. This sector of the insurance industry is facing severe challenges today due to a number of factors, including: the losses incurred as a result of the September 11 terrorist attacks; increased liability expenses for asbestos, toxic mold, D&O liability and medical malpractice; and years of declining investment returns and consistently negative underwriting results. Some companies have begun to exit insurance markets as they realize that they can no longer write these coverages on a break-even basis, let alone at a profit. The end result is increased prices and declining product availability to consumers. This situation is exacerbated by the current State-by-State system of insurance regulation.

The FAME study mentioned earlier in my testimony notes that the current U.S. system of regulation can be characterized as a prescriptive system that generally imposes a comprehensive set of prior constraints and conditions on all aspects of the business operations of regulated entities. Examples of these requirements include prior approval or filing of rates and policy forms. Although the prescriptive approach is designed to anticipate problems and prevent them before they happen, in practice, this approach hinders the ability of the insurance industry to deal with changing marketplace needs and conditions in a flexible and timely manner. This approach also encourages more regulation than may be necessary in some areas, while diverting precious resources from other areas that may need more regulatory attention.

It is also important to note that insurers wishing to do business on a national basis must deal with 51 sets of these prescriptive requirements. This tends to lead to duplicative requirements among the jurisdictions, and excessive and inefficient regulation in these areas. Perhaps the best (or worst, depending upon your perspective) example of this are the policy form and rate pre-approval requirements still in use in many states. Over a dozen states have completely de-regulated the commercial insurance marketplace for rates and forms, meaning that there are no substantive regulatory approval requirements in these areas at all. Other states, however, continue to maintain pre-approval requirements, significantly impeding the ability of insurers to get products to market. Indeed, some studies have shown that it can take as much as two years for a new product to be approved for sale on a nationwide basis. Banking and securities firms, in contrast, can get a new product into the national marketplace in 30 days or less. The lag time for the introduction of new insurance products is unacceptable. It is increasingly putting the insurance industry at a competitive disadvantage as well as undermining the ability of insurance consumers to access products that they want and need.

Let me give you an example that all Council members are familiar with: a few years ago, PAR, an errors and omissions captive insurer sponsored by The Council, sought to revise its coverage form. In most states, PAR was broadening coverage, although in a few cases, more limited coverage was sought. PAR had to refile the coverage form in 35 states where PAR writes coverage for 65 insureds. After 2 years and $175,000, all 35 states approved the filing. Two years and $5,000 per filing for a straightforward form revision for 65 sophisticated policyholders is unacceptable and is symptomatic of the problems caused by outdated rate and form controls.

We support complete deregulation of rates and forms for commercial lines of insurance. There is simply no need for such government paternalism. Commercial insureds are capable of watching out for their own interests, and a robust free market has proved to be the best price control available.

3. Access To Alternative Markets

In the last two years, high rates for property and casualty insurance have been a serious problem for many mid-sized and larger commercial firms. Hard markets such as these cause availability to decrease and the cost of coverage to increase. During these periods, insureds – particularly sophisticated commercial insureds – are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage options and hold down costs. There are two excellent mechanisms in place that offer such alternative markets: surplus lines insurance and risk retention groups. Although surplus lines insurance and insurance purchased through risk retention groups technically are less regulated than insurance in the admitted market, there are, nonetheless, State regulatory requirements – and federal laws – that apply to these alternative market mechanisms. As described more fully below, updating these regulations and laws and encouraging use of alternative insurance markets would help to increase options and decrease costs for insurance consumers.

Surplus Lines. For commercial property and casualty insurance, business is done increasingly through the surplus lines marketplace. A surplus lines product is an insurance product sold by an insurance company that is not admitted to do business in the State in which the risk insured under the policy is located. Surplus lines products tend to be more efficient because the issuing companies are less regulated and because the policies are manuscripted and therefore need not comply with State form and rate requirements. In essence, the insured goes to wherever the insurance company is located to purchase the coverage. The insurer may be in another State, or it may be in Great Britain, Bermuda or elsewhere. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers.

Although the purchase of surplus lines insurance is perfectly legal in all States, the regulatory structure governing such coverage is a morass. When surplus lines activity is limited to a single State, regulatory issues are minimal. When activity encompasses multiple States, however, full regulatory compliance is difficult, if not impossible. And I should note that multi-State surplus lines policies are the norm rather than the exception because surplus lines coverage is uniquely able to address the needs of insureds seeking coverage in more than one State. Thus, the difficulty of complying with the inconsistent, sometimes conflicting requirements of multiple State laws is a real problem. Simply keeping track of all the requirements can be a Herculean task. For example: Maryland and the District of Columbia require a monthly "declaration" of surplus lines business placed, but only require payment of premium taxes on a semi-annual basis; Virginia, in contrast, requires that a declaration be filed and taxes be paid quarterly; New Jersey has 36 pages of instructions for surplus lines filings, including a page discussing how to number the filings and a warning not to file a page out of sequence because that would cause a rejection of the filing and could result in a late filing.

The problems with State surplus lines laws fall into four general categories:

- Taxes: States have inconsistent and sometimes conflicting approaches regarding the allocation of premium taxes, which can lead to double taxation and confusion when a surplus lines policy involves multi-state risk.
    - Single situs approach – 100% of the premium tax is paid to the insured's State of domicile or headquarters State. (This approach is imposed by some States regardless of what percentage of the premium is associated with risks insured in the State.)

  - Multi-state approach – Premium tax is paid to multiple States utilizing some method of allocation and apportionment based upon the location of the risk(s).
  - No clear requirement – More than a dozen States that impose surplus lines premium taxes do not have statutory or regulatory provisions indicating the State's tax allocation method, leaving it up to the insured and the insured's broker to determine how to comply with the State law. In such States, determination of tax allocations is often based on informal guidance from State insurance department staff.
- Declinations: Some, but not all, States require that an attempt be made to place coverage with an admitted insurer before turning to the surplus lines market. Some States specifically require that one or more licensed insurers decline coverage of a risk before the risk can be placed in the surplus lines market. State declination requirements are inconsistent and conflicting, however, and the methods of proving declinations vary tremendously – from specific requirements of signed affidavits to vague demonstrations of "diligent efforts."
- Status of Insurers:
  - Most States require that a surplus lines insurer be deemed "eligible" by meeting certain financial criteria or having been designated as "eligible" on a State-maintained list. These lists vary from State to State, making it potentially difficult to locate a surplus lines insurer that is "eligible" in all States in which placement of a multi-state policy is sought. Although the NAIC maintains a list of eligible alien (non-U.S.) surplus lines insurers, this does not seem to have any bearing on the uniformity of the eligible lists in the individual States.
  - In addition to eligibility, another problem with respect to the status of insurers occurs when multi-State surplus lines coverage is placed with an insurer that is an admitted (not surplus lines) insurer licensed in one of the States in which part of the risk is located. This is problematic because surplus lines insurance cannot be placed with a licensed insurer. In these situations, more than one policy will have to be used, or the insured will have to use a different surplus lines carrier.
- Filings: All States require surplus lines filings to be made with the State insurance department. The type and timing of such filings vary from State to State, but may include filings of surplus lines insurer annual statements, filings regarding diligent searches/declinations, and filings

detailing surplus lines transactions. Depending on the States in question, filings can be required annually, quarterly, monthly or a combination thereof. In addition, some States treat "incidental exposures" – generally relatively small surplus lines coverages – differently from more substantial coverages. States have differing definitions of what constitutes incidental exposures and who has to make required filings for such an exposure: some states require the broker to make the filings; others the insured; and some require no filings at all for incidental exposures.

Risk Retention Groups. Enacted in 1981, the Product Liability Risk Retention Act was developed by Congress in direct response to the insurance "hard market" of the late 1970s. The current version of the law – the Liability Risk Retention Act of 1986 – was enacted in response to the "hard market" of the mid-1980s and expanded the coverage of the Act to all commercial liability coverages. Risk Retention Groups (RRGs) created under the Act are risk-bearing entities that must be chartered and licensed as an insurance company in only one State and then are permitted to operate in all States. They are owned by their insureds and the insureds are required to have similar or related liability exposures; RRGs may only write commercial liability coverages and only for their member-insureds.

The rationale underlying the single-State regulation of RRGs is that they consist only of "similar or related" businesses which are able to manage and monitor their own risks. The NAIC has recognized that the purpose of Risk Retention Groups is to "increase the availability of commercial liability insurance."

B. Solutions – Congressional Leadership and Action is Critical if Insurance Regulatory Reform is to Become a Reality

The FAME study notes that all the regulatory modernization efforts attempted by the NAIC in the past several years have been the direct result of major external threats – either the threat of federal intervention, or the wholesale dislocation of regulated markets. The study concludes that there is no guarantee the State-based system will adopt further meaningful reforms without continued external threats to the States' jurisdiction, and it offers the progress on producer licensing reform as a prime example. The Council wholeheartedly agrees with this conclusion. Too much protectionism and parochialism interferes with the marketplace, and the incentive for reform in individual States simply does not exist without a federal threat. Thus, congressional involvement in insurance regulatory reform is entirely in order and, in fact, overdue.

The Council believes it is critical to the long-term viability of the U.S. insurance industry that Congress pass legislation to address the deficiencies of the state insurance regulatory system. Broad reforms to the insurance regulatory system are necessary to allow the industry to operate more efficiently, to enable the insurance industry to compete in the larger financial services industry and internationally, and to provide consumers with a strong, competitive insurance market that brings them the best product at the lowest cost.

As we all know, there are, essentially, two approaches to insurance regulatory reform currently under consideration – the "roadmap" that addresses reform issue-by-issue and the optional federal charter. These approaches, although different, are not necessarily mutually exclusive – partial reform now does not rule out further reform in the future.

The "roadmap" approach being developed by House Financial Services Committee Chairman Mike Oxley (R-OH) and Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee Chairman Richard Baker (R-LA), lays the groundwork for aggressive reforms that will provide desperately needed modernization in insurance regulation. It builds upon state-based efforts and provides both carrots and sticks to force states to effectively respond to the critical need for reform. The proposal would go a long way toward resolving many of the most deep-seated insurance regulation problems, particularly with respect to the producer issues that are of specific concern to Council members. The Oxley-Baker proposal would build on the NARAB template, expanding reciprocity requirements to all 50 States, and requiring uniform licensing standards – including criminal background checks – in every State, resulting in the first truly seamless, national insurance producer licensing system.

The Oxley-Baker proposal is a comprehensive plan that, in addition to producer licensing, addresses the spectrum of insurance regulatory issues. It would resolve the surplus lines market access issues by updating and streamlining the current dysfunctional semi-regulatory process; it addresses speed to market problems caused by unnecessarily cumbersome rate and form regulation; and it attacks a number of other insurance regulatory issues that are dealt with in patchwork fashion by the States, including market conduct, company licensing and life insurance matters.

The roadmap proposal could prove to be a huge step on the road to insurance regulatory reform. Having said that, however, we believe the ultimate solution – at least for the property and casualty industry – is enactment of legislation creating an optional federal insurance charter. An optional federal charter would give insurers and producers the choice between a single federal regulator and multiple State regulators. It would not dismantle the State system, rather it would complement the State system with the addition of a federal partner. It is likely that many insurers and producers – particularly those who operate in a single State or perhaps a small number of States – would choose to remain State-licensed. Large, national and international companies, on the other hand, would very likely opt for a federal charter, thereby relieving themselves of the burden of compliance with 51 different regulatory regimes.

I am encouraged to hear that Senators Sununu (R-NH) and Carper (D-DE) are developing optional federal charter legislation. The Council has been a strong advocate for such legislation for a number of years, and we look forward to working with all of you to develop the proposal from concept into reality. Realistically, we understand that it could take several years for optional federal charter legislation to be enacted. It is a major undertaking with a great number of issues to be resolved. Political reality dictates that it will not be an easy process, nor will it be quick. Let me be clear that The Council is in this for the long haul. We will work with you until our common goal is reached. Between now and then, however, insurance regulation is in desperate need of reform. In order to better serve our policyholders and clients, we need practical solutions to real marketplace problems. We believe the Oxley-Baker proposal provides those practical solutions and, by streamlining and updating critical insurance regulatory processes, will set the stage for creation of an optional federal charter.

In closing, as I noted above, improvements in the State insurance regulatory system have come about largely because of outside pressure, notably, from the Congress. Despite its ambitious reform agenda, the NAIC is not in a position to force dissenting states to adhere to any standards it sets. Thus, it is clear that congressional leadership will be necessary to truly reform the insurance regulatory regime in the United States. On behalf of The Council, I thank you for your genuine interest in fixing this important piece of our financial infrastructure. I also thank Chairman Shelby and Senator Sarbanes for their leadership in this area. Your attention to this critical issue is heartening. We stand ready to assist you in any way that we can to advance this important effort.

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