



American Insurance Association

**STATEMENT OF
THE AMERICAN INSURANCE ASSOCIATION**

BEFORE THE

**COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE**

ON

**STATE OF THE INSURANCE INDUSTRY: EXAMINING THE CURRENT
REGULATORY AND OVERSIGHT STRUCTURE**

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Good morning, Chairman Dodd, Ranking Member Shelby and members of the Committee. My name is Alessandro Iuppa, and I am Senior Vice President, Government and Industry Affairs for Zurich North America. I appreciate the opportunity to speak with you on behalf of Zurich, the American Insurance Association (“AIA”), and its more than 350 members, on the subject of insurance regulatory reform. This is a critical issue for insurance consumers, agents, carriers, and the overall strength of the U.S. economy.

Zurich Financial Services Group is an insurance-based financial services provider with a global network of subsidiaries and offices in North America, Europe, Latin America, Asia, and other markets. Zurich was founded in 1872, and in 1912 was the first foreign insurer to enter the U.S. market. Zurich employs approximately 58,000 people worldwide, including approximately 11,000 people in 38 U.S. states, and serves customers in more than 170 countries. We are one of the leading global underwriters of life and personal as well as commercial property and casualty insurance.

In the U.S., Zurich is the third largest writer of commercial property and casualty insurance, and we provide insurance and risk management services for many of Fortune's Global 100 companies, as well as for individuals and small and mid-sized businesses. Zurich is also affiliated with Farmers Group, Inc., headquartered in Los Angeles, CA, which manages the member-owned Farmers Inter-Insurance Exchanges and their subsidiary companies. Farmers has more than 19,000 employees, 15,000 exclusive agents and 10 million policyholders around the country, and as a Group are the nation's third largest personal lines insurer of homeowners and private-passenger auto risks, the fifth largest insurer of small business and one of the largest life insurers in the country.

I come to the issue of insurance regulatory reform with a perspective different from some of the other witnesses at today's hearing. Prior to joining Zurich, I was an active member of the regulatory community for over 20 years, serving as Commissioner in Nevada, as Superintendent in Maine, as well as a consultant to insurance departments seeking to rehabilitate financially troubled insurers. During my nine plus years as Maine Superintendent, I was engaged on insurance issues nationally and internationally through the National Association of Insurance Commissioners (NAIC) and the International Association of Insurance Supervisors (IAIS). I had

the honor of serving as NAIC President in 2006 and Chairman of the IAIS Executive Committee from 2004 - 2006.

When I concluded my regulatory career, I chose to join Zurich because it is a leader in the global marketplace and a thought leader in the public policy debate on issues such as insurance regulatory reform. Indeed, in 2007 Zurich published a White Paper titled *Regulation and Intervention in the Insurance Industry – Fundamental Issues*. We are, I believe, an agent for positive change in the effort to create a regulatory system that protects insurance consumers (our customers) and, at the same time, allows market participants – the carriers, producers and others who provide insurance products to consumers – to thrive.

Zurich and the AIA are not opposed to regulation of insurance. I would not be here if we were. We support prudent, strong, state-of-the-art insurance regulation that allows insurers to meet the needs of their policyholders and encourages competitive and thriving markets nationally and globally. Although the existing state structure works for some, it impedes our ability to achieve those goals.

Introduction

The issue of insurance regulation, once thought to be the province of isolated industry practitioners and regulators, is now central to many of the critical public policy debates over the direction of the financial services sector and the U.S. economy. More than one hundred bills relating to insurance have been introduced in this Congress, many of them within the jurisdiction of this Committee. Insurance regulation, specifically Optional Federal Chartering (“OFC”), is featured prominently in both the Bloomberg/Schumer report on U.S. Global Financial Services Leadership and the Treasury Department’s Blueprint for a Modernized Financial Regulatory System. Both reports recommend the establishment of a federal insurance regulatory structure to provide for the creation of an OFC system. We agree strongly that an OFC would play an important role in the new world of integrated and interconnected financial markets, and would address the increasing cost and efficiency burdens that our disjointed state insurance regulatory system imposes on insurers and consumers alike.

Underlying this activity is recognition of the important role that the insurance industry now plays in our new financial world. Financial markets in general have undergone extraordinary growth and structural change in recent decades. Much of this change is due to developments such as the worldwide integration of capital markets, the revolution in information technology, and shifting attitudes toward competition and protection in the financial services area. Modernization of the U.S. insurance regulatory structure is necessary if we expect to maintain a strong, vibrant insurance sector. It also is essential to address policyholder needs in the 21st century. Zurich first invested in the U.S. market 96 years ago and now operates throughout the world. Like us, our clients have risks and exposures that transcend state and national boundaries and increasingly are international in scope. This reality differs markedly from the nineteenth century when state regulation of insurance began – and even from two decades ago when I began my career in insurance regulation.

Unfortunately, the current U.S. insurance regulatory structure is not fully equipped to supervise the sophisticated insurance marketplace of the 21st century. The need to operate within the state-by-state patchwork of regulation in the U.S. means that insurers with customers with worldwide operations are hindered in their efforts to manage complex risk issues as they seek to do business on a national and international platform. Moreover, the turmoil that has recently roiled the financial services sectors highlights the interconnectedness of our financial system and the importance of insurance to the proper functioning of that system. This is precisely the time to enact regulatory reforms that strengthen solvency oversight for insurers at the federal level in order to mitigate problems that may cause policyholders to suffer in time of loss.

We are grateful to you for your willingness to conduct a comprehensive review of the current regulatory system. This marks a major undertaking with a plethora of issues and interests that will require careful consideration and deliberation. We also wish to commend Senators Johnson and Sununu for their introduction of the National Insurance Act of 2007 (S. 40). The bill establishes an excellent framework to reach the goal of an optional federal charter for the insurance marketplace. It will provide real choices for all participants – insurance companies and insurance agents and brokers and, most importantly, insurance consumers. Zurich and the entire AIA membership support the legislation and look forward to working with the Committee as it moves forward.

The State of Insurance Regulation

An exclusively state-based system for the regulation of insurance, codified by the McCarran-Ferguson Act in 1945, made sense when risks and the potential for loss were concentrated in relatively small geographic areas and insurance markets were similarly small. Indeed, state regulation may still make sense for many of the approximately 6,500 insurers currently operating in the United States who operate on a single state or regional basis and serve a customer base with similar interests. Nevertheless, for many insurers and policyholders, the world has changed – and changed dramatically.

Although some risks and insurance markets remain local or state-based, in general, insurance has become a national and international marketplace in which risks and losses are widely spread throughout the world. Rather than encouraging increased availability and addressing the cost of insurance to cover such multi-jurisdictional risks, the state regulatory system does just the opposite. By artificially making each state an isolated individual marketplace with its own rules and standards, the state-based system constrains the ability of carriers to innovate and has a negative effect on the availability and cost of coverage.

To their credit, the state insurance regulators, individually and through the NAIC, have attempted to institute regulatory reforms that focus on uniformity and consistency, and they have made some strides in recent years toward simplifying and streamlining regulatory requirements. We appreciate that effort, and we continue to work with them to make the system more workable in the modern world.

The reality, however, is that today's marketplace demands far more dramatic action than the states alone are able to provide. Large insurers' increasingly global footprint continues to outstrip the pace of reform efforts by state regulators and legislatures. Efficiency in the insurance marketplace lags behind other financial services sectors due in large part to the regulatory structure's shortcomings and inconsistencies, issues that must be addressed if the U.S. insurance sector is to be in a position to match the pace of change in the rapidly evolving global marketplace and thereby expand the insurance marketplace for the benefit of insurers, producers

and consumers. In short, it is not that the states are not trying to adapt, but it is the fact that the state-by-state structure simply does not work efficiently for insurers, producers and consumers that are regional, national and international players. Even at the highest level of competence and cooperation, states have limited options due to their narrow market focus and statutory frameworks.

Broad reform of the insurance regulatory system is necessary to provide insurance consumers with strong, competitive insurance markets that deliver the best products at the lowest cost, allow the industry to operate more efficiently, and enable the industry to compete in the larger financial services industry and internationally. Reform should be focused on one thing: creating a national marketplace, a market unencumbered by geographic borders.

Let me be clear, we are advocating for a regulatory system that retains prudential oversight and fosters greater transparency, better consumer protection, heightened efficiency both for the companies and the regulators, more product availability, and increasingly competitive markets. To achieve such a system, we believe that an optional federal charter is the best choice. It will allow those who seek access to broader financial services markets to do so by obtaining a federal charter. At the same time, those who wish to continue under the state system can continue to do so. The choice should be based on sound business considerations, not a singular regulatory system.

State Regulation Hinders U.S. Globally

Over the last several years as an insurance regulator I spent a great deal of time working on behalf of the U.S. regulatory community – at home and abroad – with our foreign colleagues and the international insurance community. The NAIC has been active for many years in international policy issues, both to protect U.S. consumers who purchase coverage from non-U.S. insurers and for trade purposes – to develop bilateral and multilateral trade, open markets around the world, and maintain the U.S. industry’s global competitive position. Despite the best efforts of the U.S. regulatory community, however, its effectiveness on the international stage is constrained – not necessarily in the development of policies and ideas, but in terms of

implementing those policies and ideas at home in order to make the international marketplace function more effectively.

Let me give you an example: the IAIS has become the de facto standard setter with respect to international insurance standards commensurate with the Basel Committee for Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) for the securities industry. Since its inception in 1994, the IAIS has adopted 13 Standards, 15 Guidance Papers and a set of Core Principles. U.S. regulators have been and continue to be active participants in the development of those standards and principles, but no matter the degree of agreement among the regulators, the U.S. representatives are not in a position to bind the U.S. regulatory community to adopt those standards. That right belongs to each state – through its legislature – which can, within its sovereign authority, adopt the standards, modify them before adopting them, or refuse to adopt them as they see fit. The ability of a single U.S. regulator to bind its state is questionable at best. Unfortunately, this limitation applies not only to agreements with foreign regulators, but to model laws and other NAIC actions, as well. The fact is, it is difficult to gain a consensus among the state regulators on any one issue, and even when consensus is reached, state-by-state execution makes nationwide uniform adoption and implementation nearly impossible.

Likewise, the introduction of risk-based insurer solvency requirements across the European Union, through an initiative that is known as “Solvency II,” will pose enormous challenges to state-regulated insurers. The new solvency requirements are intended to be more risk-sensitive and more sophisticated than in the past, thus enabling better tracking of the real risks run by any particular insurer, while at the same time encouraging competition and innovation. As a result, trade experts believe that Solvency II will enhance the international competitiveness of EU insurers to the detriment of their U.S. peers. U.S. insurers cannot be easily integrated into Solvency II because the U.S. does not provide supervision equivalent to that of the EU. Because it is merely a committee of well-intentioned, individual state supervisors and not a national regulatory body that can guarantee uniformity and consistency, the NAIC cannot adequately address this situation. As noted in a recent analysis of Solvency II by Standard and Poors, “in the absence of supervisory equivalence, non-EU insurers may find themselves operating at a competitive disadvantage in Europe.” U.S. insurers are also concerned that the growing

cohesiveness of the EU under Solvency II will yield cost and efficiency benefits for EU insurers that cannot be realized under the highly fragmented state system in the U.S.

A federal insurance regulator under OFC would change this dynamic. A National Insurance Commissioner, with the authority to negotiate and bind the federal government, would add immeasurably to the effectiveness of our international endeavors to the benefit of U.S. insurance consumers. Even more immediately, an insurance office inside the Treasury Department could gather information, develop expertise, and assist USTR in international trade agreements affecting insurance. I have no doubt the states would remain involved internationally and encourage them to do so. Doing so alongside the federal government will bring a measure of practical importance to their activity that is absent in today's environment.

Strong Consumer Benefits

The current regulatory system assigns rhetorical importance to “consumer protection” but in fact focuses attention on regulatory functions that are not in the best interests of consumers, be they individuals, small businesses, or large corporations. Consumers across the spectrum will be better protected by a regulatory system that focuses on solvency and market conduct regulation, not on price and product approvals. Over the long-term, OFC will result in a stronger, more competitive, and modernized insurance industry that is better able to meet the needs of consumers and to empower those consumers in the marketplace, while reducing unnecessary costs—costs which have been estimated by the American Consumer Institute at more than \$13 billion per year.

Additionally, consumers will benefit from access to new and improved consumer products, more companies competing for their business, and more streamlined ways of doing business, particularly for those who have homes in more than one state or move frequently. To further bolster consumer protection, S. 40 establishes consumer affairs and insurance fraud divisions to provide strong consumer service and protection.

State Regulation Unable to Address National Problems

State insurance regulators, through the NAIC, have and continue to construct regulatory reforms with national implications, regrettably with limited success. The NAIC financial accreditation program is a prime example of state regulation and cooperation at its best. But efforts to export the success of the accreditation program to other regulatory initiatives, such as market conduct, have moved slowly. Even the Interstate Insurance Product Regulatory Commission, which is an undisputed success for the states, covers only 33 member states, or 54 percent of the premium for covered products (life insurance, disability, long term care, and annuities), to date.

The reality is that today's marketplace – both national and international – demands faster and far more dramatic action than the states alone are able to provide. As I have mentioned, insurance is no longer the local market it once was. Insurance consumers have exposures across the country and around the globe, so state boundaries no longer match our customers' national and international business models. And the states – with their differing and sometimes conflicting laws and rules, their sometimes widely varying interpretation of those laws and rules, and their inconsistent and sometimes inflexible implementation – are simply not equipped to handle this increasingly complex and sophisticated marketplace.

Although these may seem like small issues – and individually, state to state, the differences may appear inconsequential – taken as a whole, they constitute a significant burden on insurers, to the ultimate detriment of consumers. Moreover, I question the overall consumer protection value of many of the idiosyncratic state rules, and whether significant regulatory differences from state to state really serve to protect national insurance consumers.

Although the tension between state regulation and the modern insurance marketplace is evident across the spectrum of regulation, I would like to briefly address two areas that would benefit from federal regulation: market deficiencies and speed to market.

Market Deficiencies

The lack of a sustainable market for terrorism coverage and coverage shortfalls in some coastal regions illustrates a deficiency in the U.S. marketplace. There are many reasons insurers do not cover terrorism or certain property risks, and we should all be clear from the beginning that a

federal regulator will not solve every problem that arises in the marketplace; I am not aware of any regulator that has been able to accomplish that. Regulation, however, can play an important role in helping markets operate as efficiently as possible. In some situations, it can amplify problems that already exist in the marketplace, rather than help markets function for the benefit of policyholders and insurers. Artificial limitations on business and barriers to entry distort markets and ultimately do not benefit consumers.

Additionally, by making each state an individual marketplace, the current regulatory structure inhibits the ability of insurers to spread risk and enhance capacity, while at the same time perpetuating an uneven national regulatory system. As we have learned from painful experience, terrorism, floods, hurricanes, earthquakes, wildfires and other natural catastrophes rarely respect state borders. The problems created by mega-catastrophes are regional and national issues.

Over the years, Congress has increasingly acted to address national problems, and congressional actions have envisioned in their underlying premise a significant role for the federal government. A logical next step would be to create a single national insurance regulator with the ability to oversee the national market and interact with the legislative branch. From an implementation perspective, enforcement of federal insurance-related legislation typically has been left to the states, each of which understandably has its own concerns with its local markets. A federal regulator with responsibility for federally chartered insurers will be better able to respond to national problems.

Speed To Market

A number of states still require the prior approval or the filing of rates and policy forms before those products can be offered for sale in the state. In several states, commercial insurance products can be introduced immediately into the marketplace, but other states continue to maintain pre-approval requirements. For personal lines, most states play a major role in dictating the coverage insurers must offer and the premiums insurers are allowed to charge, even if that means providing coverage at a loss.

Although the intent of these requirements is 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 by significantly impeding the ability of insurers to get products to market. My experience taught me that of the approximately 1,000 companies licensed to underwrite insurance products in Maine, very few sought to introduce products that did not comply with state laws and regulations. But for those products that did require prior approval, the search for “potential problems” slowed the pace of product introduction to the policyholder community.

For insurers functioning in regional or national markets, this approach can lead to duplicative requirements among the jurisdictions, and excessive and inefficient regulation, diverting not only the resources of the carriers that are required to comply, but also regulatory resources that may be better utilized elsewhere. Our company, for example, works with many of the Fortune 100 companies – large multinational entities with coverage needs that span state and national borders. In our effort to better serve our multinational clients, we developed the Zurich Multinational Insurance Proposition (MIP). With Zurich MIP, our global customers can be confident that their out-of-territory coverage is aligned with local licensing and premium tax requirements. For our clients indemnifying risks in the U.S., compliance would be much simpler if Zurich had a federal charter. I mention this because compliance in these areas is an important policyholder protection.

Insurance Regulatory Reform: An Optional Federal Charter

Zurich and the AIA membership believe the best solution is enactment of legislation creating an optional federal insurance charter as contemplated in the National Insurance Act. An OFC would give insurers and producers the choice between a single federal regulator and multiple state regulators. It will not dismantle the longstanding state insurance regulatory framework; rather it will 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. Multi-region, national and international companies, on the other hand, would more likely opt for a federal charter, thereby relieving themselves of the burden of compliance with 56 different regulatory regimes.

The National Insurance Act creates an optional federal regulatory structure for both the property and casualty and life insurance sectors; that option extends equally to insurance companies, reinsurers and insurance agents and brokers (producers); and the bill carefully addresses essential elements of insurance regulation including licensure, policy form oversight, guaranty funds, and state law preemption. The Act preserves the state system for those that choose to operate at the state level, but offers a more sophisticated, yet uniform regulatory structure for insurers and producers that operate on a national and international basis in this increasingly global industry.

- ***Creates an optional insurance regulatory system for all industry players.*** An OFC would provide insurance companies, reinsurers and producers a choice to operate under federal or state oversight. The Act preserves the ability of those industry participants to operate under State licenses, while giving both the option of doing business under a single federal license.

- ***Provides insurance producers a choice between federal and state oversight and in no way increases regulatory burdens on producers.*** Far from creating additional licensure and other regulatory requirements for insurance producers, the Act has the potential of significantly reducing the regulatory burdens producers face. Under the Act, for example, federally licensed producers would be subject to a single set of disclosure and other consumer protection requirements. Insurance producers also can choose to keep their existing state licenses and sell for all insurers – state and national – wherever they hold a state license. Or they can choose a single national license and sell for all insurers – state and national – in all U.S. jurisdictions. An additional benefit for “national producers” is the single set of requirements covering qualifications to do business, testing, licensing, market conduct and continuing education. Although the states have taken some steps in recent years toward uniform and reciprocal producer licensing requirements, it will be many years before they will enjoy such a streamlined system at the state level – if ever.

- ***Insurance consumers, too, have a choice.*** Consumers will retain complete control to choose the insurers and producers with whom they wish to do business. If a consumer

deems it important that their insurance company be subject to the rules of a particular state or the federal regulator, they can use that as a factor in their purchase decision.

- ***Consistent consumer protections for insurance policyholders nationwide.*** At present, insurance consumer protections are uneven from state to state. Under the Act, consumers purchasing products from national insurers would have the same high level of protections and rights without regard to their state of residence. Nor would their rights and protections change simply because they relocate across state lines.
- ***The consumer protections in S. 40 are as strong as those in any state.*** The ultimate consumer protection is strong financial oversight of insurers. In this regard, the Act requires a level of financial oversight consistent with the best employed by the states. The Act goes on to require that every insurer undergo a market conduct examination at least once every three years, creates a Division of Fraud and a Division of Consumer Affairs, leaves intact the state guarantee system to insure that policyholders are protected in case of insurer insolvency, makes the commission of a “fraudulent insurance act” a federal crime, and subjects National Insurers to federal antitrust laws in those areas such as insurance pricing where market competition replaces regulation.

In closing, as I have discussed above, the state insurance regulatory system is not best suited to oversee the complex, sophisticated, international marketplace that insurance has developed into over the past half century. There remains a role for the states, but a large segment of the business of insurance – and the consumers that such insurers serve – have moved beyond artificial state boundaries. It is long past time that the regulation of that business move beyond those artificial boundaries, as well.

Thank you, again, for your interest in these issues and for your consideration of the views of Zurich and the AIA. We look forward to working with the Committee as you move forward with this important initiative.