

Testimony of the  
National Association of Insurance Commissioners

Before the  
Committee on Financial Services  
United States House of Representatives

Regarding:  
“Regulatory Restructuring: Enhancing Consumer Financial  
Products Regulation”

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Ralph S. Tyler  
Commission of Insurance  
State of Maryland  
On Behalf of the National Association of Insurance Commissioners

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Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today on enhancing consumer financial product regulation. My name is Ralph Tyler. I am the Commissioner of the Maryland Insurance Administration and I am here today on behalf of the National Association of Insurance Commissioners (NAIC).

In light of turmoil in the financial markets, legislators and regulators are appropriately questioning the structure and protections of our financial regulatory system. Much of that attention has been on the efficiency and effectiveness of financial or prudential supervision. But equal attention must be given to consumer protection encompassing not just financial supervision but market regulation and oversight of company conduct.

It is clear that some areas of the financial regulatory system have separated these two critical missions: financial supervision and consumer protection. While that may be an appropriate structure for other financial sectors, the states believe insurance has unique challenges best handled by a single regulatory department. Product design directly affects solvency, so we do not think supervision of these areas should be separated. Unlike other financial products, insurance is a promise to pay an unknown cost if an unknown event occurs. While a fundamental consumer protection is the underlying ability of the insurer to honor those promises, it also includes how the insurer treats its customers, beginning with the contents of the policy through claims payment. What also makes these products unique is that consumers tend to interact with insurers only when a negative event has transpired, creating additional strain on the relationship between the insurer and the policyholder.

The states have developed a wide range of consumer protection tools, detailed below, designed around these complex products and unique interactions between insurers and policyholders. For these reasons, we believe a new agency to regulate consumer protections in insurance is not necessary, and would cause the kind of overlaps that lead to preemption of state laws and rules designed specifically to address the complexities of insurance.

## **Establishment of Market Regulation**

Congress is appropriately asking how to ensure that consumer protection is as fundamental to financial product regulation as safety and soundness protection. Insurance regulators view these two areas, financial regulation and market regulation, as essential and linked. We have a national system for solvency assessment that has weathered the current economic crisis reasonably well, and while we believe such financial supervision is a critical consumer protection, I will focus my remarks today on market regulation.

The basic purpose of market regulation is to protect consumers by identifying and correcting insurer operating practices that are in conflict with contract provisions, state laws, rules, regulations, or orders of the Commissioner. A cornerstone of this effort is the NAIC Unfair Trade Practices Model Act. Every jurisdiction has adopted this model act or substantially similar legislation to protect consumers from inappropriate activity. The model prohibits sixteen defined unfair trade practices which, for example, include: 1) misrepresentation and false advertising, including omission; 2) providing false information, such as publishing an advertisement or announcement containing any assertion with respect to the business of insurance that is untrue, deceptive or misleading; and 3) distributing any literature that is false or maliciously critical of or derogatory to the financial condition of any insurer, calculated to injure such insurer.

Coupled with the Unfair Trade Practices Act is the Unfair Claims Settlement Practices Act, which provides consumers the necessary protections during the insurance claims process. This model act, adopted in forty-seven jurisdictions (the remaining states have similar protections), prohibits insurers from engaging in the following practices: (1) misrepresenting material facts or policy provisions relating to coverage; (2) failing to make a good faith effort to pay claims with clear liability; (3) trying to make unreasonably low claim settlements; and (4) failing to approve or deny coverage within a reasonable time after receiving a proof-of-loss statement.

These laws provide a framework of consumer protection that gives state insurance departments broad authority to intervene on behalf of insurance policyholders.

## Company Licensing

The ability to license or not license an insurance company to conduct business in Maryland is a powerful tool I have to protect consumers from bad actors. During the company licensing process, a state insurance department reviews the financial resources of the applicant to ensure there is a minimum level of capital and reserves to operate as an ongoing insurance company. In addition, attention is given to the officers and directors of the applicant to ensure that the listed individuals have the minimum level of competency and trustworthiness. Finally, the company will be licensed for a specific line or lines of authority. As part of this process, the state insurance department obtains an understanding of the products to be sold and the market to be served. Some common questions a state insurance department attempts to answer include: (1) does the insurer have the financial capacity to write the business?; (2) does the insurance company have the appropriate expertise?; (3) can the insurer properly price the product?; and (4) will the insurer be competitive?

States carry out this licensing function through the Uniform Certificate of Authority Application, or UCAA, which all states have adopted. The UCAA is an electronic application form that sends the relevant licensing information to each state, preserving each state's ability to perform an independent review. As part of this effort, the NAIC has also published a Company Licensing Best Practices Handbook to assist regulators in reviewing licensing applications.

## Producer Licensing

In addition to scrutinizing a company that wants to sell insurance, regulators must also scrutinize the primary point of sale for insurance. Similar to company licensing, an insurance department will also license the business entities (agencies) and individual producers (agents and brokers) selling insurance products. This is an extremely important process, as most consumers look to their insurance agent as the expert on insurance. The producer licensing process includes examinations, background checks, and continuing education requirements to ensure that individuals selling, soliciting or negotiating insurance have the appropriate knowledge and are of good moral character. Throughout this process, state insurance regulators retain broad authority to deny, suspend or revoke an insurance producer's license. In 2007, state insurance regulators

reported nearly 16,000 license suspensions, 1500 license revocations, 333 cease and desist orders, over \$25 million in producer fines and nearly \$30 million in restitution to consumers.

All of these activities are coordinated through the State Producer Licensing Database (SPLD), a central repository of producer licensing information updated regularly by participating state insurance departments. Currently, the SPLD includes information from all fifty states, as well as the District of Columbia and Puerto Rico.

In 2007-2008, the NAIC membership initiated and completed a comprehensive Producer Licensing Assessment Project, an on-site review of each state’s producer licensing laws and processes. Through the NAIC, states have also made tremendous progress in national uniformity and reciprocal treatment of producers using electronic licensing initiatives. As of January 31, 2009, the following states utilize the electronic licensing services of the National Insurance Producer Registry, a non-profit affiliate of the NAIC:

- Non-Resident Licensing for Individuals – 49 states.
- Non-Resident Licensing for Business Entities – 34 states.
- Non-Resident Renewals for Individuals – 39 states.
- Electronic Funds Transfer for State Fees – 47 states.
- Address Change Requests – all states.
- Electronic document storage for applicants – all states.

Consumer Services

Once the companies, producers and products are in the marketplace, 1,600 state consumer service personnel help monitor the marketplace by handling consumer inquiries and consumer complaints. The consumer service representatives in state insurance departments are truly the front line regulators, as they interact with consumers on a daily basis. They respond to over 2.3 million consumer inquiries and 370,000 formal consumer complaints each year. Information for the state of Maryland is below:

	2006	2007	2008
Complaints received	14,435	13,399	12,482
Complaints closed	15,092	13,557	12,903
Recovery	\$5.4 million	\$5.4 million	\$5.7 million
Orders	17	26	29

Administrative penalty	\$5,500	\$16,750	\$7,250
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In order to make this type of information more accessible to consumers, the NAIC has established the Consumer Information Source (CIS) (<https://eapps.naic.org/cis/>) to give insurance consumers across the country a centralized location to access marketplace information on insurers. Through the CIS, consumers can access key information, including closed insurance complaints, licensing information and key financial data. In addition, consumers can file an insurance complaint directly through the CIS.

#### Antifraud/Criminal Investigation

To deal with issues involving criminal activity, many insurance departments have antifraud and criminal investigators who work closely with federal, state and local law enforcement officials to prosecute insurance fraud. To help fight fraud, the NAIC created a uniform fraud reporting system through which consumers and insurance companies can electronically report suspected fraud to the appropriate insurance department. In addition, the NAIC maintains the Special Activities Database (SAD) to capture market activities and legal actions involving entities engaged in the business of insurance. Fraud adds unnecessary cost to insurance consumers, so my staff actively works to bring bad actors to justice. As an example, we recently investigated a producer suspected of embezzling \$39,113 from an insurance company. The producer admitted to writing six separate checks to himself and his wife from the insurer's checking account. We ordered the producer to pay the full \$39,113 in restitution, revoked his license and referred the matter to the Fraud Division for criminal prosecution. Maryland is not unique in this effort. There are over 1,200 state employees involved in anti-fraud and related enforcement activities.

#### Rate and Form Review

Again, because the ultimate value of insurance is only known after the product is purchased and a claim is filed, states have taken steps to review the adequacy and appropriateness of many insurance products before they are made widely available. State insurance regulators recognize that insurance policies are very complicated contracts that many, if not most, insurance consumers do not read or understand. With that in mind, insurance departments review policy forms to ensure that consumers are getting the coverage they've paid for, and that the policy provisions are in compliance with statutes and regulations for readability and the offer of

mandated benefits. This approach also assures the public that the policy is sold for a legal purpose, has an appropriate insuring agreement, and does not contain exclusions, exceptions or conditions that are contrary to law.

Because insurance rates are based on actuarial analysis and assumptions that are challenging for the average consumer to determine, states have stepped in to review insurer rates and rate methodologies. With rate review, the general standard of review is to determine if the rates are adequate but not excessive or unfairly discriminatory. To streamline the filing of rates and forms, the NAIC has developed the System for Electronic Rate and Form Filing (SERFF), now used in fifty-one jurisdictions. SERFF is an electronic processing system that in 2008 allowed 2,851 insurance companies to make 554,261 rate and form filings to the states.

### Market Analysis

States have taken significant steps recently towards the creation of a more systematic, structured and uniform market analysis program. The purpose of market analysis is to identify, assess and prioritize market conduct problems that have a substantial adverse impact on consumers, policyholders and claimants. Through this effort, state analysts are able to identify companies that warrant further regulatory scrutiny. As part of this process, state analysts can use the NAIC's Market Analysis Review System to get a basic understanding of a company under review, to eliminate companies that do not warrant further analysis and to begin investigating the cause of an anomaly when a company does warrant additional analysis.

The NAIC has also created the confidential Market Analysis Prioritization Tool, which allows market analysts to compare similar companies on a national and state basis, and the Market Conduct Annual Statement, which provides for the capture of much needed market data from insurance companies. The Market Conduct Annual Statement allows companies to be compared on an equal basis using uniform data and helps regulators allocate market regulation resources where they can be most effective.

### Market Conduct Examinations

A key component of consumer protection for insurance is on-site examinations of insurers through market conduct examinations. Market conduct examinations involve direct contact with

a company to discuss and correct an identified problem or to obtain a better understanding of how the company is operating in the marketplace. While usually completed on a targeted basis using upon market analysis, states have broad authority to examine company management and operations, marketing and sales, underwriting, customer service, claims handling and licensing. Market analysis and market conduct examinations are a critical component of consumer protection, with over 600 state employees and another 100 contractors involved in these functions. In the state of Maryland, there have been tangible benefits for consumers:

	2006	2007	2008
Property and casualty	39 investigations/exams \$278,000 penalties \$19.1 million restitution	144 investigations/exams \$1.1 million penalties \$6.8 million restitution	245 investigations/exams \$533,000 penalties \$2 million restitution
Life and health	8 investigations/exams \$400,000 penalties \$0 restitution	11 investigations/exams \$490,000 penalties \$950,000 restitution	15 investigations/exams \$740,000 penalties \$0 restitution
Producer enforcement	443 cases closed \$50,000 penalties \$1.6 million restitution	441 cases closed \$27,000 penalties \$3.4 million restitution	683 cases closed \$110,000 penalties \$5.9 million restitution

### **Interstate Collaboration**

Clearly there is a robust system for consumer protection at the state level, but the states have also made great strides to coordinate their efforts wherever possible and appropriate. Through the NAIC, the states have a forum to coordinate market analysis and examination efforts. By implementing market analysis techniques and sharing pertinent information, states can identify those regulated entities where there is a shared concern regarding the regulated entities' market practices. Also through the NAIC, the states maintain centralized data collection so that key information on consumer complaint tracking, examination tracking and enforcement actions is available to all states without duplication of cost or effort. These efforts provide for a national system of consumer protection, with local control and responsiveness to meet the needs of consumers in varying state markets.

### The Interstate Compact: Uniform Standards and Single Approval for Life Products



In the life insurance sector, states have gone beyond the forum of NAIC to create a system of uniform standards and approval, while retaining the checks and balances of state-based consumer protections. Life insurance risks do not vary from state to state the way property risks do, and the products lend themselves to uniform treatment. To preserve state market regulation while streamlining the standards and approval process for this sector, the states have formed an interstate compact, called the Interstate Insurance Product Regulation Commission (IIPRC), to develop a single set of uniform standards and a single point of product review and approval for life insurance, annuities, disability income and long-term care insurance.

IIPRC has been adopted by thirty-five states and Puerto Rico (Compacting Member States), and represents over half of the premium volume nationwide. The concept was developed in 2002 and became operational in 2006 when twenty-six states passed enabling legislation. The IIPRC is a public entity treated as an instrumentality of the Compacting Member States. The IIPRC provides the States with a vehicle to: (1) develop uniform national product standards that will afford a high level of protection to consumers of life insurance, annuities, disability income and long-term care insurance products; (2) establish a central point of filing for these insurance products; and (3) thoroughly review product filings and make regulatory decisions according to the uniform product standards.

The Compact requires that product standards prohibit the use of any inconsistent, misleading or ambiguous provisions. It also requires that the form of the product made available to the public shall not be unfair, inequitable or against public policy as determined by the IIPRC. Companies maintain the choice of filing products through the IIPRC or filing products directly with a state. IIPRC represents a unique tool that combines national treatment, uniform standards, and state consumer protections.

#### Federal Consumer Financial Protection Agency

States have a long history of consumer protection, with the ability to respond quickly when problems arise. This responsiveness can lead to inconsistencies among various state laws, but any cost associated with complying with these different state laws is offset by the value of a strong and nimble regulatory system. The current financial crisis illustrates this reality, as regulatory systems built to emphasize uniformity and efficiency over responsibility and effectiveness were primary sources of systemic risk and systemic failure.

The fundamental question for today's hearing is: How should the financial regulatory system be improved to ensure consumers are protected? As a state insurance regulator, it is not for me to decide whether a separate agency is necessary for other financial sectors, or whether empowering existing regulators with a consumer protection mandate is the best course of action for those different products. However, it is clear that there was a lack of attention to market regulation in certain segments of the financial system, and it is in those areas that Congress should focus its efforts and taxpayer resources.

What the Congress should not do, in our view, is to empower that agency to wade into insurance, an area where strong consumer protections have long been a fundamental tenet of supervision and embedded in our regulatory and legal systems. It is the strong standards in the states that, in part, cause our critics to call for broader federal preemption. We do not need a competing federal regulator to feel the pressure from our industry and the Congress for sustained reform, but a competing regulator, no matter how innocuously envisioned, will ultimately erode a state system that is inherently centrist and undeniably effective.

Our system is not without its flaws and challenges. Congress has never shied away from pointing out where we can do better, and we welcome that scrutiny. If there are areas of insurance consumer protection that need improving, I would venture a guess that the states are aware of and working on those issues already. But stripping that fundamental authority from the states, or bifurcating it with a federal entity that inevitably will cause conflicts, confusion, and down the road, preemption, will do nothing to solve the problems exposed by our financial crisis.

As you approach this legislation, please be guided by the Hippocratic Oath imposed on the medical profession – above all, do no harm.

Thank you for the opportunity to testify, and I look forward to your questions.