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on behalf of The Council of Insurance Agents & Brokers

Before a Hearing of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"The Need for Insurance Regulatory Reform"

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Good morning, Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee. My name is Albert Counselman. I am Chairman and CEO of Riggs, Counselman, Michaels and Downes (RCM&D) in Baltimore, MD and past Chairman of The Council of Insurance Agents & Brokers ("The Council"), on whose behalf I testify today. Thank you for this opportunity to speak with you today on the need for insurance regulatory reform.

The Council represents the nation's leading insurance agencies and brokerage firms, including RCM&D. 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 $200 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 to secure innovative solutions and create new market opportunities for its members at home and abroad.

Riggs, Counselman, Michaels and Downes, the largest independent agency / brokerage firm in Maryland, has doubled in size in the last five years. We have a staff of nearly 300 people working from five offices – in Baltimore, Washington, Richmond, Virginia Beach and Harrisburg. With over $40 million in annual revenue and $400 million in annual premiums placed for our clients, we are one of the 65 largest commercial insurance agents and brokers in the United States, as reported by Business Insurance. Our clients range from large, multi-state employers in the Fortune 1000, to large and small hospitals, to mid-sized and small businesses and individuals. The firm provides risk management, including risk control and claim management programs, commercial and personal insurance, self-insurance and employee benefit programs. We work with most of the largest and most well known insurers operating in the U.S. and many located overseas.

RCM&D has been in business since 1885 and continues to be privately owned by individuals active in the operation of the business. Through our ownership and membership in organizations such as Assurex Global, we service clients locally as well as throughout the U.S. and the globe.

Introduction

Insurance regulatory reform, which is critical for the long-term health of our industry, is long overdue. Modernization of the insurance regulatory structure is an important element in maintaining a strong, vibrant insurance sector and is essential to allow the marketplace to evolve in order to address the needs of insurance policyholders in the 21st century. Unfortunately, the current regulatory structure for insurance is simply not equipped to handle an insurance marketplace that today is not just national but international in scope and also is both increasingly complex and sophisticated. My firm serves clients in 50 states and multiple countries – not unlike most of the other member firms of The Council, yet strikingly different from the local mode of operation that existed for many of us 20 – or even 10 – years ago. Like the marketplace, our clients have risks and exposures that transcend state boundaries and are both national and international in scope. The current state regulatory patchwork quilt of regulation not only has not kept up but cannot keep up due to the globalization of the business, and the current regulatory failures have had a very real and detrimental impact on the availability and affordability of coverage for commercial insurance consumers.

The Council is not opposed to regulation. Our members support prudent regulation that benefits consumers, but the current state structure does not get us that. This is why we are a strong supporter of insurance regulatory reform and are working so hard for change.

As a preliminary matter, we would like to thank the Subcommittee for its successful efforts in crafting the Non-admitted and Reinsurance Reform Act (H.R. 1065) and achieving unopposed adoption of the bill on the House floor. Title 1 of the bill would streamline the regulation of the surplus lines insurance marketplace, primarily dictating that the rules and regulations only of the insured's home state would apply to any multi-state surplus lines transaction. The NRRA is a critical piece of insurance regulatory reform legislation, the adoption of which will have an immediate positive impact on consumers and the insurance marketplace and, equally important, will complement the adoption of the broad-based regulatory reform envisioned by pending OFC legislation.

The Council also is very grateful to Representatives Bean and Royce for drafting and introducing The National Insurance Act of 2007, H.R. 3200. Representatives Bean and Royce and their staffs have assumed a major undertaking with a great number of issues and interests that will require careful consideration and deliberation, and we recognize it may take some time to reach the finish line. Having said that, the legislation provides an excellent framework to reach that goal and we endorse the bill wholeheartedly. The Council has been a strong advocate for regulatory reform – specifically a federal charter option – for a number of years. We support the Bean / Royce legislation for many reasons, not the least of which is its purely voluntary nature – voluntary for companies and agents/brokers, as well as consumers. The bill provides real choice for all participants in the insurance marketplace.

The State of Insurance Regulation

Background

The insurance marketplace has changed and evolved in the millennia since ancient traders devised systems for sharing losses, and in the centuries since the Great Fire of London led to the creation of the first fire insurance company. Indeed, insurance has become increasingly sophisticated and complex since the enactment 60 years ago of the McCarran-Ferguson, which preserved a state role in the regulation of insurance.

In the United States, insurance has historically been governed principally at the state, rather than the national, level. This historic approach, codified by McCarran-Ferguson in 1945, made sense when risks and the impact of losses due to those risks was concentrated in relatively small geographic areas and the insurance markets were similarly small. Initially, risks were generally local and losses were most likely to be felt by the local community. Fire, for example, was a major threat not only to individual property-owners, but to entire communities because of the widespread devastation fire can cause. As populations and economies grew, so did the risks, and the impact of losses became more widespread. The pooling of risks has grown ever wider, and more sophisticated as well.

Initially, state regulation of insurance addressed those needs. The primary objective of insurance regulation has always been to monitor and regulate insurer solvency because the most essential consumer protection is ensuring that claims are paid to policyholders. State regulation initially advanced that goal by giving consumers with no direct knowledge of carriers based in other communities the comfort that they would be able to – and would – pay claims when they came due. This, in turn, led to increased availability and affordability of coverage because carriers were able to expand their reach, making the insurance marketplace more competitive.

But things have changed. While some risks – and insurance markets – remain local or state-based, in general, insurance has become a national and international marketplace in which risks are widely spread and losses widely felt. The terrorist attack on the World Trade Center and the devastation caused by Hurricane Katrina are, perhaps, the two most notable examples, but many policyholders, particularly in the commercial sector, have risks spread across the country and the globe. Rather than encouraging increased availability and improving the affordability of insurance to cover such risks, the state regulatory system does just the opposite. By artificially making each state an individual marketplace, it constrains the ability of carriers to compete and thereby reduces availability and affordability.

Continuing Problems under the Current Regulatory System

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 states have made some strides in recent years in simplifying and streamlining regulatory requirements. We appreciate that and we continue to work with them to make the system more workable in the modern world. That said, however, the inconsistent, duplicative and often-times conflicting nature of state-by-state regulation plagues our membership. I would like to focus this portion of my testimony on four specific areas that illustrate some of the failings of the current regulatory system: (1) coverage gaps; (2) agent/broker disclosure/transparency; (3) licensure reform; and (4) speed to market issues.

1. Securing Coverage – Current Problems

Arguably the largest shortcoming inherent in the current system is the inability of that system to address coverage gaps and to enhance capacity. The most visible examples of this are the terrorism and natural catastrophe coverage shortfalls. Although Congress has attempted to fill this void with the enactment of TRIA and through its consideration of a variety of solutions to the natural catastrophe coverage issues, those efforts ultimately can serve as no more than band aids that are administered in a regulatory vacuum that attempt to cure perceived symptoms without addressing the fundamental problems. It is difficult or even impossible for the federal government to step into the natural catastrophe void, for example, without having authority to address the regulatory shortcomings related to the underlying coverage it is seeking to augment.

This disconnect can be seen vividly post-Katrina in two very different respects. First, the flood versus wind coverage debates create very real coverage problems for consumers based on the disconnect between the flood component of their coverage and the wind component. It is simply untenable for the federal government to have a flood insurance program that is supposed to work hand in hand with other coverage with which it may not be in synch. Second, some of the affected Gulf Coast states have responded by making their markets even more difficult for carriers to access, exacerbating capacity issues for their residents. It is perhaps for these reasons that the NAIC itself – in testimony given earlier this year – recommended that the federal government administer an all-perils coverage program for homeowners. In essence, the NAIC was recommending a federal system for that component of the business, presumably in recognition of the inability of the states to adequately provide for that sector.

2. Transparency – Well Intended But Inconsistent Requirements

In today's marketplace, it is imperative that insurance brokers be transparent in their business dealings with their clients. The Council has been at the forefront of pushing for the enactment of uniform disclosure rules and regulations. Almost every state imposes explicit requirements on what must be disclosed and when if a broker is both collecting a commission from a carrier and a fee from the client. We embrace this transparency agenda. The problem is that it is virtually impossible to satisfy the differing requirements of the states with a uniform compliance approach. Some states, for example, fully allow the simultaneous receipt of both fees and commissions with disclosure. Other states allow the simultaneous receipt of a commission and a fee for non-placement related services provided that the client is made aware of this and affirmatively agrees to it. Still other states, however, impose a variety of differing limitations, some prohibiting the collection of fees altogether – even in lieu of commissions – on the theory that this may jeopardize their premium tax revenue base.

Some Council members would prefer to move to a compensation model under which their sole compensation comes from fees paid by the client, with no commissions at all. Even though this presumably would be preferred by these members' clients and would completely resolve the issues that the fee/commission transparency requirements endeavor to address, it is essentially impossible to effectuate. This is because many states prohibit insurers from quoting coverage "net" of commission. In some states, the articulated rationale is that this would place some agencies at a disadvantage in the marketplace. In other states, the concern appears to be based more on the overarching desire to ensure that the premium tax revenue base is as broad as possible. In still other states for mandated lines of coverage such as workers compensation, the motivating rationale appears to be the desire to preserve a cost comparison base for future regulated pricing.

Many Council members also assist larger commercial clients with the placement of premium financing. Council members generally disclose that they will be compensated by the lenders for these services. Some states require more explict disclosures. California requires use of a specific form that includes disclosure mandates at odds with those imposed in other states.

Almost half the states also have premium trust fund regulatory requirements. Brokers often collect the premiums on the policies they place and these rules require that premium payments held on behalf of carriers be maintained in separate, segregated accounts. Again, the Council and its members share the ultimate objective of these requirements but again the problem is in the implementation. Some states appear to require that premiums associated with exposures in those states be maintained separately; other states impose express investment and fiduciary limitations on the manner in which the funds are maintained.

For clients with exposures across the nation and their brokers who are endeavoring to serve them efficiently and economically, the differing and conflicting rules and requirements and the inflexibility of their application in some states serves no apparent consumer protection oriented purpose and is at odds with the scope of the activities in which the consumers these states are attempting to protect are engaged.

3. Producer Licensure: Welcome Improvements, but Incomplete Reform

The concrete progress that the States have been able to make in their regulatory reform efforts has primarily 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 both time and money.

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, nearly all the states have enacted some sort of licensing reform, and the NAIC has officially certified that a majority of states have met the NARAB reciprocity requirements, thereby averting creation of NARAB. This is a good effort, but problems remain; there is still much work to be done to reach true reciprocity and uniformity in all licensing jurisdictions.

Most states retain a variety of individual requirements for licensing, and they all differ with respect to fees, fingerprinting and certifications, among other requirements. Although most of the states have enacted the entire PLMA, a number of states have enacted only the reciprocity portions of the model. Of the states that have enacted the entire PLMA, several 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. Many Council member firms continue to hold hundreds of resident and non-resident licenses across the country. The 183 producers in my firm, for example, hold 183 resident licenses in four states, and 512 non-resident licenses. One of the larger members of The Council holds almost 50,000 resident and non-resident licenses for 5,400 individual producers, and approximately 3,400 resident and non-resident entity licenses for itself and its subsidiaries/affiliates. And this is not a "once and done" deal – state licenses, by and large, must be renewed annually throughout the year, based upon the individual requirements in each state, and there are continuing regulatory requirements and post-licensure oversight that must be attended to, as well. As you can imagine, this requires significant monetary and human resources from each and every producer. This is especially frustrating because, let's face it, the incremental consumer protection value of the tenth or hundredth or thousandth or 50,000th license is questionable, at best.

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.

It also applies to interpretation and application of statutory language. For example, as I have mentioned, most of the states have enacted new producer licensing laws based in whole or part on the NAIC's Producer License Model Act, which was adopted by that organization in 2000. Yet seven years later, the regulators still cannot agree on the meaning of basic – yet critical – terms that are present in every state law, such as what it means to "sell," "solicit" and "negotiate" insurance. Nor can they agree on the meaning of other critical provisions of the law – even when the language in their individual state provisions are identical – word for word. While these may seem like small issues – and individually they may be – taken as a whole, they are significant. It is a bit like Senator Dirksen's take on congressional about spending, but instead of "a billion here and a billion there," we are talking about a regulation here and a rule there.

In addition to the day-to-day difficulties the current regulatory regime imposes, this inconsistent application of law among the states inhibits efforts to reach full reciprocity in producer licensing. As I have mentioned, several states have failed to adopt GLBA-compliant reciprocal licensing regimes, including two of the largest insurance markets – California and Florida. These states, in large part, are disinclined to license as a non-resident a producer whose home state (they believe) has "inferior" licensing standards to their own, even a state with similar or identical statutory language. Thus, they are not reciprocal because they do not trust their fellow states to sufficiently regulate producers. This strikes us as indefensible – regulators defending the system of state regulation of insurance while essentially admitting that consumers in some states benefit from stronger oversight than others.

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 even 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.

More problematic is the fact that every state requires the filing of "additional information" if an applicant responds affirmatively to certain background or other questions on an application. Council members have no objection to the regulators looking into the background of a producer applicant and asking for explanatory information if, for example, a producer has had regulatory or legal issues in the past. We hold ourselves to the highest standards and think the regulators should, as well. Our objection is with the repetitiveness and burdensome nature of the process. The additional information that must be submitted with an application generally must be submitted in paper form (or fax) – it cannot be submitted electronically. Thus, the technological benefit of the uniform electronic application is nullified.

Let me give you an example: We have been attempting to secure a business entity producer license (the necessity of which – in terms of consumer protection – is questionable at best) in a New England state. First, we were required to apply for name approval from the state insurance department, which took several months. After the name was approved, we were required to submit the original paperwork and required documentation to the secretary of state to get the business entity established in the state. This took close to eight months, a length of time that was totally unnecessary. We sent the state the originals of all the required documentation, only to receive copies back from the state saying they needed the originals. Of course, because we had sent them the originals, we only had our copies to work with – so we had to go back to square one and recreate everything. Finally, after nearly a year and the exchange of three sets of “originals” and “copies” of the documents in question with the secretary of state, my staff contacted the state and was told we had been approved. The state made no effort to contact us, and we had never received anything notifying us of our approval. After locating evidence of the secretary of state approval on a government website, we submitted the actual license application to the state insurance department. That was more than three months ago. We have yet to hear back, and all requests result in a response that the application is "in process." As frustrating as this process has been, it has real business implications for my firm. We consistently receive inquiries from carriers looking for proof of licensure in that state.

Another example of unnecessary regulatory burdens comes from a fellow Council member: This brokerage and several of its subsidiaries entered into a settlement with the department of insurance of a northeastern state. The settlement agreement was posted by the department on its website and posted by the broker on its website. Nonetheless, every time the broker or one of the named subsidiaries applied for a license renewal in the state with which it had entered into the settlement, the firm/subsidiary was required to submit a copy of the settlement agreement. Thus dozens, if not hundreds of copies of the settlement agreement were filed with a department that had negotiated and agreed to the settlement and posted the document on its website.

Undeniably, progress in streamlining the producer licensing process has been made since GLBA’s NARAB provisions were enacted in 1999. It is clear, however, that despite the revolutionary NARAB achievements, comprehensive reciprocity and uniformity in producer licensing laws remains elusive, and it does not appear the NAIC and the states are capable of fully satisfying those goals. We believe the OFC proposal offers producers a viable alternative to the state system – an alternative that will provide oversight and protections consumers need and demand, and the ease and flexibility that producers need. As an added benefit, as we learned with GLBA and other federal legislation, when Congress acts, the NAIC and states listen. So movement on OFC will put pressure on the states to step up their own regulatory reform activity in an effort to stave off federal intervention. We are already seeing evidence of this at the NAIC, where regulators have established a coalition to take the next step in producer licensing reform. We fully support their efforts and are working with the regulators to achieve results at the state level, but that is no substitute for federal action on the matter.

4. Speed to Market

The state-by-state system of insurance regulation also gives rise to problems for insurers that directly affects the availability of coverage for our clients. 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 ultimately inure to the detriment of our clients and thus 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.

Most Council members sell and service 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 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 55 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 re-file 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. The proposed National Insurance Act contemplates this approach by restricting the federal regulator's authority to dictate rates or the determination of rates.

Insurance Regulatory Reform: Despite recent improvements, the states clearly cannot solve the problems with insurance regulation on their own, so congressional action is necessary.

Although the state insurance regulators, through the 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. As I have mentioned, insurance is no longer the local market it once was. It is a national and international marketplace, the development of which is far outstripping the pace of reform efforts by state regulators and legislatures. The state regulatory system is simply not equipped to handle this increasingly complex and sophisticated marketplace and state boundaries no longer match our clients' national and international business models. Competition and efficiency in the insurance industry lag behind other financial services sectors due to the regulatory inefficiencies and inconsistencies in the state insurance regulatory system. These inefficiencies and inconsistencies 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 provide adequate and affordable coverage to insurance consumers.

The Council regards itself as a pioneer within our industry with respect to regulatory modernization, although 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 (GLBA) several years ago – a first step on the road to insurance regulatory reform. The proposed National Insurance Act is the next step on the road to modernization.

In an effort to get better leverage on the reform options, the Council 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 synopsis of the study is attached to my testimony. I hope it will serve as a useful tool as you consider insurance regulatory reforms.

The FAME study reinforced The Council's long-standing belief that it is critical to the long-term viability of the U.S. insurance industry that regulatory relief is needed, and it is needed now. 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.

I want to emphasize at the outset that we are not advocating deregulation of the insurance marketplace or any reduction in consumer protections. What we are advocating – as we did with NARAB and producer licensing reform – is fixing the current regulatory system to allow insurance companies and producers to have a choice between state and federal oversight. Many insurers and producers will likely choose to remain within the state system because it works best based on the size of their business and their customer base. For the same reasons, others will choose the federal option. For this latter group, jettisoning the current multi-state system for a single federal regulator makes eminent good sense, allowing them to avoid the overlapping, burdensome dictates of 55 jurisdictions for a single regulator and thereby easing regulatory burdens – and doing so without sacrificing consumer protections. We believe the long-term effects of such reform on the marketplace will ultimately benefit the consumer by increasing capacity and improving availability of coverage.

Studies have shown that 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. It follows that there is no guarantee the state-based system will adopt further meaningful reforms without continued external threats to the states' jurisdiction. 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. 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.

1. Surplus Lines Insurance and Risk Retention Groups

In the last several 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 that prevent this marketplace from fully realizing its potential.

As we have mentioned, The Council strongly supports the surplus lines reform that has passed the House and is now under consideration in the Senate and believes such legislation will not detract at all from the debate over the OFC, nor is a substitute for that legislation. In fact, we believe it will help set the stage for creation of an optional federal charter.

Risk Retention Groups (RRGs) 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. 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.

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." The Council supports expanding the LRRA to allow RRGs to write property as well as liability coverage to enhance their ability to increase the availability of commercial insurance.

2. An Optional Federal Charter

Having said that, however, we believe the ultimate solution is enactment of legislation creating an optional federal insurance charter as contemplated in the National Insurance Act. An OFC regime would enhance the surplus lines and risk retention group reforms and support their further extension through the commercial marketplace. An optional federal charter also 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 55 different regulatory regimes.

The National Insurance Act creates an optional federal regulatory structure for both the life and property & casualty insurance industries; that option extends equally to both insurance companies and insurance agents and brokers (producers); and the bill carefully addresses essential elements of insurance regulation including licensure, rate approval, 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 regulatory structure for insurers and producers that operate on a national and international basis in this increasingly global industry.

- ***H.R. 3200 creates a truly optional insurance regulatory system for all industry players.*** The structure it creates gives insurance companies and producers a real choice as to whether they want to operate under federal or state oversight. The Act preserves the ability of insurers and insurance producers to operate under state licenses, while giving both the option of doing business under a single federal license.

- ***H.R. 3200 gives 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 producers that choose a national license is that they would be subject to a 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 retain complete control to choose the insurers and producers with which 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.

- ***Consumers' product choices will expand.*** A single federal regulator for national insurers will give insurance consumers expanded product choices. By offering an alternative to the multiple-state regulatory hoops that insurers must now jump through, the federal charter will enable insurers to get products to market in a more streamlined fashion. This will enable them to address consumers' needs more quickly and more specifically with products tailored to consumer needs.

- ***H.R. 3200 bolsters rather than diminishes current protections for insurance consumers.*** At present, insurance consumer protections are uneven from state to state. Some states have a robust system of consumer protection, while others devote fewer resources to it. Under the Act, consumers purchasing products from national insurers would have the same protections and rights whether they live in Los Angeles, Topeka or Providence. Importantly, their rights under a policy would not change simply because they move across the Potomac from Washington to Alexandria.

- ***The consumer protections in H.R. 3200 are stronger than those in many states and provide protections that are simply unavailable in many states.*** For example, the Act requires every insurer to undergo both a financial and a market conduct examination at least once every three years. In addition, the Act provides for the creation of a Division of Fraud, Division of Consumer Affairs, and an Office of the Ombudsman to protect consumers. The Act makes the commission of a "fraudulent insurance act" a federal crime and subjects National Insurers to federal antitrust laws.

- ***The Act provides for comprehensive, rigorous oversight of insurers and insurance producers that protects producers in case of insolvency and is comparable to the best practices currently in place in the states.*** In addition to traditional consumer protections, the Act protects insurance consumers in another essential way: federally-chartered insurers will be subject to the financial solvency oversight of a federal regulator with the resources and staff to adequately supervise large corporations that may be beyond the capability of the states. The Act provides for financial and market conduct examinations every three years, allows for self-regulatory organizations to be created to police the industry, ensures that sufficient resources and federal attention will be devoted to insurance oversight, and does not eliminate or reduce in any way the ability or effectiveness of state insurance regulation. In addition, H.R. 3200 leaves the state guaranty system intact to ensure that policyholders are protected in case of insurer insolvency. The Act sets stringent standards that state funds must meet in order to secure national insurer participation. A national guaranty fund is established to protect policyholders in states where the guaranty fund falls short of the national standards.

The Council has been a strong advocate for legislation such as the National Insurance Act for decades. We realize this 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. We look forward to being a constructive voice in this debate.

In closing, and as I noted above, despite its ambitious reform agenda, the NAIC is not in a position to force dissenting states to adhere to any standards it sets. Moreover, in many ways the business of insurance – and the consumers that business needs to serve – have moved beyond artificial state boundaries and it is long past time that the regulation of that business move beyond those artificial boundaries as well. On behalf of The Council, I thank you for your genuine interest in these issues. We stand ready to assist you in any way.

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