**STATEMENT OF ALEX SOTO**
**ON BEHALF OF THE**
**INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA**

**BEFORE THE**

**SUBCOMMITTEE ON CAPITAL MARKETS, GOVERNMENT SPONSORED ENTERPRISES, AND INSURANCE**

**COMMITTEE ON FINANCIAL SERVICES**

**UNITED STATES HOUSE OF REPRESENTATIVES**

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Good afternoon Chairman Kanjorski, Ranking Member Pryce, and Members of the Committee. My name is Alex Soto, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA). Thank you for the opportunity to provide our association's perspective on insurance regulatory reform. We welcome an open discussion and debate on this very important topic. I am the Immediate Past Chairman of IIABA, and I am also President of InSource, which is an agency that was formed from a merger of three of Miami's oldest insurance agencies. Through our practice specialties, InSource has made a long-term and total commitment to our South Florida community.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we are a network of more than 300,000 agents, brokers, and employees nationwide. IIABA represents small, medium, and large businesses that offer consumers a choice of policies from a variety of insurance companies. Independent agents and brokers provide a variety of insurance products – property, casualty, health, life, employee benefit plans and retirement products.

**Introduction**

It is clear that there are inefficiencies today in the regulation of insurance, and there is growing consensus that the state system of insurance needs to be modernized. There is disagreement, however, on the most effective and appropriate way to achieve reform. Some support pursuing reform in the traditional manner, which is to seek legislative and regulatory improvements on an ad hoc basis in the various state capitals. Another approach, that some international and large domestic insurance companies advocate, would establish a federal insurance bureaucracy to regulate the insurance industry through "optional" federal chartering. Others, such as IIABA, support a pragmatic middle-ground approach that uses targeted federal legislation only where necessary, while maintaining and improving the existing system of state insurance regulation.

As we have for over 100 years, IIABA supports state regulation of insurance – for all participants and for all activities in the marketplace – and we oppose any form of federal regulation, optional or otherwise. Yet despite this historic and longstanding support of state regulation, we do not believe the state system can appropriately and effectively address certain of its problems on its own. That is why we feel that there is a vital role for Congress to play in helping to modernize the state regulatory system and overcome the obstacles to reform that currently exist; however, such an effort need not replace or duplicate at the federal level what is already in place and working well at the state level. Through targeted federal legislation along the lines of H.R. 1065, the Nonadmitted and Reinsurance Reform Act, which the House passed by voice vote this summer, we can streamline and modernize the state-based system without having to take the drastic step of creating a new federal agency.

During this discussion of potential insurance regulatory reform, we must recognize, and we ignore at the marketplace's peril, that the current state system of insurance regulation does have significant strengths – particularly in the area of consumer protection. State insurance regulators have done an excellent job of ensuring that insurance consumers, both individuals and businesses, receive the insurance coverage they need and that any claims they may experience are paid. These and other aspects of the state system are working well. The "optional" federal charter concept proposed by some would displace the components of state regulation which work well and, in essence, "throw the baby out with the bathwater."

To explain the rationale for our support of targeted legislation to achieve insurance regulation reform, I will first offer an overview of both the positive and negative elements of the current insurance regulatory system. I will then provide a more complete explanation of the approach that we believe offers the most appropriate vehicle to modernize and improve the state-based regulatory system. I will then outline the reasons for our strong opposition to proposals to create an "optional" federal charter for insurance.

**The Current State of Insurance Regulation**

From the beginning of the insurance business in this country, states have carried out the essential task of regulating the insurance marketplace to protect consumers. The current state insurance regulatory framework began in 1851 when New Hampshire appointed the first insurance commissioner. Insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved.

State regulation of insurance has been reaffirmed as recently as 1999 through the Gramm Leach Bliley Act (GLBA). Specifically, Title III of GLBA unequivocally provides that "[t]he insurance activities of any person (including a national bank exercising its powers to act as agent . . .) shall be functionally regulated by the states," subject only to certain exceptions which are intended to prevent a state from thereby frustrating the affiliation policy adopted in GLBA. The GLBA provisions collectively ensure that state insurance regulators retain regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. These mandates are intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Most observers agree that state regulation works effectively to protect consumers, largely because state officials are positioned to be responsive to the needs of the local marketplace and local consumers. Unlike most other financial products, which are highly commoditized, the purchaser of an insurance policy enters into a complex contractual relationship with a contingent promise of future performance. Therefore, the consumer will not be able to determine fully the value of the product purchased until after a claim is presented – when it is too late to decide that a different insurer or a different product might make a better choice. When an insured event does occur, consumers often find themselves in a crisis, facing many challenging issues and perplexing questions; as a result, they must have quick and efficient resolution of any problems, and a local call works best.

Unlike banking and securities, insurance policies are inextricably bound to the separate legal systems of each state, and the policies themselves are contracts written and interpreted under the laws of each state. Consequently, the constitutions and statue books of every state are thick with language laying out the rights and responsibilities of insurers, agents, policyholders, and claimants. State courts have more than 100 years of experience interpreting and applying these state laws and judgments. The diversity of underlying state reparations laws, varying consumer needs from one region to another, and differing public expectations about the proper role of insurance regulation require local officials "on the beat."

Protecting policyholders against excessive insurer insolvency risk is one of the primary goals of state insurance regulation. If insurers do not remain solvent, they cannot meet their obligations to pay claims. State insurance regulation gets high marks for the financial regulation of insurance underwriters. State regulators protect policyholders' interests by requiring insurers to meet certain financial standards and to act prudently in managing their affairs. The states, through the National Association of Insurance Commissioners (NAIC), have developed an effective accreditation system for financial regulation that is built on the concept of domiciliary deference (the state where the insurer is domiciled takes the lead role). When insolvencies do occur, a state safety net is employed: the state guaranty fund system. States also supervise insurance sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase products and file claims.

**<u>Targeted Insurance Regulatory Reform</u>**

Despite its many benefits, state insurance regulation is not without its share of problems. As I mentioned earlier, there is general agreement among both policymakers and the private sector that insurance regulation needs to be updated and modernized. While the existing system does have many benefits, it also has been rightly characterized as slow and inefficient with different laws and regulations in some areas that add unnecessary expense. These criticisms are accurate, and there is a desperate need for a common-sense solution. Therefore, while we do continue to strongly support the state system, we question whether the states will be able to resolve their problems on their own. For the most part, state reforms must be made by statute, and state lawmakers inevitably face practical and political hurdles and collective action challenges in their pursuit of improvements on a national basis.

We believe that congressional legislative action is necessary to help reform the state regulatory system. We propose that two overarching principles should guide any such efforts in this regard. First, Congress should attempt to fix only those components of the state system that are broken. Second, no actions should be taken that in any way jeopardize the protection of the insurance consumer, which is the fundamental objective of insurance regulation and of paramount importance to IIABA and its members.

IIABA believes that the best method for addressing the deficiencies in the current system is a pragmatic, middle-ground approach that utilizes targeted legislation or federal legislative "tools" to establish greater interstate consistency in key areas and to streamline the often redundant oversight that exists today at the state level. By using targeted and limited federal legislation on an as-needed basis to overcome the structural impediments to reform at the state level, we can improve rather than dismantle the current state-based system and in the process produce a more efficient and effective regulatory framework. Rather than employ a one-size-fits-all regulatory approach, a variety of legislative tools could be employed on an issue-by-issue basis to take into account the realities of today's marketplace. This can be accomplished through enactment of a number of bills dealing with particular aspects of insurance regulation starting with those areas in most need of reform where bipartisan consensus can be established.

Congress's work in this area need not jeopardize or undermine the knowledge, skills, and experience that state regulators have developed over decades. While IIABA believes such a proposal must modernize those areas where existing requirements or procedures are outdated, it is important to ensure that this is done without displacing the components of the current system that work well. In this way, we can assure that insurance regulation will continue to be grounded on the proven expertise of state regulators at the local level. Targeted federal legislation addresses limited aspects of state insurance regulation only where uniformity and greater consistency is truly necessary and is the least intrusive option. Unlike other ideas, such as an "optional" federal charter, this approach does not threaten to remove a substantial portion of the insurance industry from state supervision and effectively preempt all application of state law.

Some have criticized the targeted federal legislative approach because of enforcement concerns. The reality, however, is that court enforcement of federal preemption occurs regularly and would occur under both the federal tools approach and in other proposals such as the "optional" federal charter. As long as federal reform legislation is properly crafted and clear, enforcement of national standards would not create more burdens for the court system.

As evidence of the viability of this approach, targeted legislation to reform an aspect of the insurance industry has already passed the House of Representatives. In June of this year, H.R. 1065, the Nonadmitted and Reinsurance Reform Act of 2007, introduced by Reps. Dennis Moore and Ginny Brown-Waite passed the House by voice vote. Similar legislation was passed by this Committee and by the full House in a unanimous vote last year. This legislation would apply single-state regulation and uniform standards to the nonadmitted and reinsurance marketplaces and give sole regulatory and enforcement authority to the insured's home state for the placement of non-admitted insurance. Unlike other reform proposals, this legislation has near-unanimous industry support and, as evidenced by the vote in the House in June, strong bipartisan congressional support. We applaud the cosponsors for introducing this legislation and the full House for its prompt passage of this important bill. This model, federal legislation modernizing state regulation, can be used to reform other aspects of the insurance market.

An additional area where targeted reform could be achieved is in the area of agent licensing. One of the most significant elements of GLBA for the insurance marketplace is the inclusion of the National Association of Registered Agents and Brokers (NARAB) Subtitle, which was intended to produce meaningful producer (i.e., agent and broker) licensing reform in a timely manner. Agents and brokers across the country hoped effective reform was imminent following GLBA's passage and the subsequent adoption of the NAIC's Producer Licensing Model Act (PLMA) by most jurisdictions, but we are still awaiting the promised benefits more than seven years later. Congress's action in 1999 certainly had the intended effect of spurring state action, but critical problems remain because the standards were not sufficiently clear, the bar was not high enough, and many states are not complying with the GLBA and PLMA standards.

While the NAIC has cited the "progress" made in the licensing arena as one of its most notable success stories, our members remain frustrated by the many challenges and burdens they face and are increasingly impatient with the lack of progress. The most serious challenges facing agents are the redundant, costly, and sometimes contradictory requirements that arise when seeking licenses on a multi-state basis, and the root cause of these problems is the failure of many states to issue licenses on a truly reciprocal basis. The PLMA and the GLBA clearly outline the limits of what may be required – *a nonresident in good standing in his/her home state shall receive a license if the proper application or notice is submitted and the fees are paid* – yet states continue to impose additional conditions and requirements.

The current licensing system is cumbersome, confusing, burdensome, and time-consuming, and it hinders the ability of agents and brokers to responsively address the needs of insurance purchasers. In most states, a nonresident must obtain three separate licenses – an individual license, an agency license, and a foreign corporation registration in each jurisdiction – in order to engage in insurance producer activities in a particular state, and these duplicative and redundant layers of licensing requirements do not benefit consumers in any meaningful respect. These and other challenges make producer licensing an area ripe for renewed congressional action. Targeted federal legislation that would ensure a completely reciprocal licensing process for producers would provide a more competitive insurance market and improve the state-based system of insurance. Additionally, such federal legislation would preserve the rights of states to license, supervise and discipline insurance producers. We look forward to working with the Committee on such legislation.

An additional area ripe for targeted reform is the product approval process. For life products, federal legislation could build upon the NAIC's interstate compact for approval of life, disability, and long-term care products. For property/casualty products, targeted legislation could facilitate the establishment of a coordinated electronic system for nationwide single point of filing, common filing nomenclature to reduce unnecessary forms filings and deviations, eliminate all unpublished desk-drawer rules, and expedite review of forms through established and enforceable time deadlines.

As I have mentioned, while there are areas of the insurance marketplace that are in need of reform, there is not a wholesale national crisis that requires such a drastic remedy as optional federal regulation (which is discussed in detail below). In addition to targeted reform, where there are significant market problems we welcome measures such as H.R. 2761, the Terrorism Risk Insurance Revision and Extension Act, and H.R. 3355, the Homeowners' Defense Act. These bills address specific problems, terrorism and natural disaster insurance issues - two areas where there has been market failure. Addressing specific problems where necessary without disrupting the entire insurance market is the appropriate way to handle such problems, and we applaud the Committee for passing both of these bills.

I want to again thank the sponsors for introducing the Nonadmitted and Reinsurance Reform Act and the House for taking such prompt action in passing this legislation. We are hopeful that this approach will be used in the near future to facilitate additional reforms in the state-based system of insurance regulation, particularly in the area of producer licensing.

**<u>"Optional" Federal Charter</u>**

I would be remiss if I did not discuss briefly our strong opposition to another suggested method to achieve insurance regulatory reform – the proposal to create a parallel and duplicative federal system of regulation by providing for an "optional" federal charter (OFC) for insurance. We are very concerned about this proposal for full-blown "optional" federal regulation of the insurance industry and believe that it would not reform the current system but would supplant and eviscerate the state system of insurance regulation.

Creating an industry-friendly "optional" regulator, as current OFC legislation provides, is at odds with one of the primary goals of insurance regulation, which is consumer protection. The best characteristics of the current state system from the consumer perspective would be lost if some insurers were able to escape state regulation completely in favor of wholesale federal regulation. As insurance agents and brokers, we serve on the front lines and deal with our customers on a face-to-face basis. Currently, when my customers are having difficulties with claims or policies, it is very easy for me to contact a local official within the state insurance department to remedy any problems. If insurance regulation is shifted to the federal government, I would not be as effective in protecting my consumers, as I have serious reservations that some federal bureaucrat will be as responsive to a consumer's needs as a local regulator.

This is because the federal regulatory model proposes to charge a distant (and likely highly politicized) federal regulator with implementation and enforcement. Such a distant federal regulator may be completely unable to respond to insurance consumer claims concerns. As a consumer, personal or business, there would be confusion as to who regulates policies, the federal government or the state insurance commissioner, and how coverages apply. I could have a single client with several policies with one company regulated at the federal level, while at the same time having several other policies which are regulated at the state level. As an agent representing clients with policies regulated at the federal and state level, though, I would be forced to understand both regulatory systems and deal with the federal government, even if I wanted to remain licensed only in my home state.

Although the proposed "optional" federal charter regulation arguably could correct some deficiencies, the cost is incredibly high. A new federal regulator would add to the overall regulatory infrastructure – especially for independent insurance agents and brokers selling on behalf of both state and federally regulated insurers – and undermine sound aspects of the current state regulatory regime. Even though it is commonly known as "optional," current federal legislative proposals to allow for such a federal insurance charter would not be at all optional for agents. Independent agents represent multiple companies, and, under this proposal, presumably some insurers would choose state regulation and others would choose federal regulation. In order to field questions and properly represent consumers, independent agents would have to know how to navigate both state and federal systems, therefore making them subject to the federal regulation of insurance – meaning OFC would not in any way be optional for insurance producers. Even more importantly, "optional" federal charter would not be optional for insurance consumers. The insurance company, not the insurance consumer, would make that determination.

Again, IIABA believes that local insurance regulation works better for consumers and the state-based system ensures a level of responsiveness to both consumers and the agents who represent them that could not be matched at the federal level. OFC proposals attempt to address this concern by providing for the establishment of federal regional offices. However, to match the local responsiveness of state regulators, a federal office would have to be established in every state, and in many cases, multiple offices within each state. This would create an entirely new and completely redundant federal regulatory layer. Why duplicate the current state-based system when you can build off its strengths and modernize it? There is no way out of this predicament for the supporters of OFC – either you significantly increase the size of the federal government to match state regulators' responsiveness to consumers or rely upon a distant federal regulator in Washington, D.C. to meet consumer needs – and they will fail to meet those needs. Additionally, an OFC would weaken the authority of state officials to protect consumers in their state. These officials tend to be more responsive to individual complaints than Washington, D.C. bureaucrats.

Ultimately, though, we believe that OFC proposals create an environment in which the state system could not survive. OFC supporters believe that this proposal would create a healthy regulatory competition that will force state regulators to cooperate and be more receptive of the role of market forces. However, when state resources are siphoned off by a new federal bureaucracy, state insurance departments could be prevented from functioning at their current capacity and the ability of state insurance departments to function and approve products in a timely manner could be diminished. Thus, companies who continue to operate under the current system might be forced to become federally chartered. Additionally, much of state insurance fees and taxes are important sources of general use revenues used for state treasuries to fund various state proposals. In 2006, state governments received almost $2.75 billion from non-premium tax revenues (e.g. fees and assessments) and $13 billion in premium taxes. Current legislative proposals would fund a new federal regulator from industry fees and assessments, so examination and other fees for federally-regulated entities will shift from state to federal coffers resulting in a significant loss of state revenue. We also believe that eventually a significant portion of state premium tax revenue will be lost to the federal government.

OFC supporters like to point to the dual banking system as an example of how regulatory competition could work, but this is an analogy that should raise many concerns. As we have seen in recent years, with the Office of the Comptroller of the Currency's (OCC) forceful assertion of preemption, federal regulatory schemes can do grave harm to state consumer protection regulations. Current OFC proposals also would create a confusing patchwork of solvency/guaranty regulation, and would not replicate the significant structural (and prudential) improvements that were made in the banking model in the aftermath of the S&L and banking bailouts. The dual structure proposed under current OFC could have disastrous implications for solvency regulation by largely bifurcating this key regulatory function from guaranty fund protection. In essence, these proposals would create an insurance version of the OCC without the integration of an FDIC into that supervisory system. Such proposals cherry-pick the features from several of these federal banking laws to come up with a model which lacks the consumer protections found in any one of them, and which ignores the problems it would create for state insurers, guaranty funds, and their citizens.

Proponents of OFC assert that a federal regulator also is important if the U.S. is to remain a global financial services leader, in that an OFC would allow insurers to compete more freely and effectively. IIABA believes that the purported decline of U.S. capital markets competitiveness for insurance companies does not stem from supposed burdensome state-based regulation, but from other U.S. competitiveness concerns such as disparate tax treatment, diverse financial reporting standards, and the costs of excessive litigation. OFC will not guarantee less restrictive regulation than that of foreign competitors (or even current state regulation).

In the end, IIABA feels that an OFC would lead to a needless federal bureaucracy and unnecessarily infringe on states' rights. Unlike GLBA which effectively <u>empowers</u> the states through uniform regulatory standards, an OFC fails to give any assistance except through the threat of regulatory competition. Thankfully there is another way to reform insurance regulation to the benefit of consumers, agents & brokers, and insurance companies: targeted federal legislation already proven successful through the Nonadmitted and Reinsurance Reform Act.

**<u>Conclusion</u>**

IIABA has long been a supporter of reforming the insurance marketplace. We worked closely with this Committee in support of GLBA and in early 2002, IIABA's Board took a formal policy position to support federal legislation to modernize state insurance regulation. While GLBA reaffirmed state functional regulation of insurance, some large insurers continue to push for an "optional" federal charter. State regulators and legislators, many consumer groups, independent insurance agents and brokers, some life insurance companies, and many property-casualty companies are strongly opposed to federal regulation. The state system has proven that it best protects consumers and can be modernized to work effectively and efficiently for the entire insurance marketplace with the right legislative pressure from Congress.

Targeted, federal legislation to improve the state-based system presents Members of Congress with a pragmatic, middle-ground solution that is achievable – something we can all work on together. The enactment of targeted federal legislation to address certain, clearly identified problems with state regulation is not a radical concept, as evidenced by prompt passage of the Nonadmitted and Reinsurance Reform Act by this Committee last year and the full House this summer. We encourage the House Financial Services Committee to continue to pursue targeted reform, specifically in the area of agent licensing reciprocity. It is the only approach that can bring the marketplace together to achieve reform.