THE COUNCIL
of INSURANCE
AGENTS & BROKERS

Statement of
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On
State of the Insurance Industry: Examining the Current Regulatory and Oversight Structure

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Good morning, Chairman Dodd, Ranking Member Shelby and members of the Committee. My name is Shad Steadman. I am the President and Chief Operating Officer of Rutherfoord, Inc., a regional insurance brokerage based in Roanoke, Virginia. Rutherfoord has eight offices stretching from Philadelphia to Atlanta. We employ more than 300 insurance professionals and are the 38th largest U.S. broker as reported this month in Business Insurance magazine. We provide insurance placements and are licensed in all 50 states as well as more than 60 other countries. Thank you for the opportunity to testify before you today on behalf of The Council of Insurance Agents & Brokers (The Council), an organization I currently chair, regarding the current insurance regulatory structure and the need for reform.

The Council represents the nation's leading insurance agencies and brokerage firms, including Rutherfoord. 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.

Executive Summary

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.

The Council is very grateful for the work of Senators Johnson and Sununu in drafting The National Insurance Act of 2007, S. 40. We believe the proposal is an excellent framework on which to build a dialogue around the issues of insurance regulatory modernization. We endorse the 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 Council has been a strong advocate for optional federal charter legislation for a number of years. We realize, however, that this is a difficult set of issues and debate will take a considerable amount of time. It is a major undertaking with a great number of issues to be resolved. Political reality dictates that it will not be an easy process, nor will it be quick. Meanwhile, however, insurance regulation is in desperate need of reform. In order to better serve our policyholders and clients, we need practical solutions to real marketplace problems. To achieve these goals, we hope the members of this committee will consider proposals in the near term that address fundamental flaws in the state-based system of insurance regulation itself and for which solutions are readily at hand.

Regulation of surplus lines insurance provides a perfect example. More than 25 percent of commercial insurance in the U.S. is placed through the “non-admitted” or “surplus lines” marketplace. Although the purchase of surplus lines insurance is generally considered to be less regulated than the “admitted” marketplace, in reality the regulatory structure governing such coverage is quite burdensome and restrains the availability of coverage. When surplus lines activity is limited to a single state, regulatory compliance issues are minimal because there is a single set of rules that govern the transaction. When activity encompasses multiple states, however, which is the norm in the surplus lines market, full regulatory compliance is difficult, if not impossible because the laws of every state in which an exposure being insured is located may technically apply to the transaction. Thus, the difficulty of complying with the inconsistent and sometimes conflicting requirements of multiple state laws is a real problem. Simply keeping track of all the requirements can be a Herculean task.

Legislation that would clean up this regulatory morass has been approved by the House of Representatives and introduced in this chamber by Sens. Mel Martinez and Bill Nelson of Florida. The Nonadmitted and Reinsurance Reform Act, S. 929 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. Similar legislation has been adopted twice on the House floor without any opposition.

Importantly, the legislation would not deregulate the non-admitted insurance marketplace or reduce consumer protections. I should note here that all of the major stakeholders are supportive of this legislation – large and small insurers and reinsurers, large and small intermediary firms, and the only organization whose explicit purpose is to represent commercial insurance consumers – the Risk Insurance Management Society. I should also note here that despite our disagreements on broader federal reforms, the National Association of Insurance Commissioners has taken a progressive stance on the surplus lines title of this legislation, and we believe that their suggestions for modest adjustments in the legislative language have merit. On that front, we are grateful for the leadership of NAIC Chairwoman Sandy Praeger of Kansas, Commissioner Jim Donelan of Lousiana (chairman of the NAIC's Surplus Lines Task Force), and Illinois Insurance Director Mike McRaith.

I should also note that there is one necessary technical change to the legislative language of S. 929, one which adjusts the definition of a "sophisticated insurance purchaser" consistent with the language adopted by the House of Representatives in 2007. The authors of the Senate bill, for whom we are greatly indebted, introduced S. 929 as it was House-approved in 2006, before the evolution of this technical but important provision.

Surplus lines regulatory reform will not detract at all from the debate over the OFC, nor is it a substitute for that legislation. But in the meantime, it is an achievable reform of the state-based regulatory system; it is a somewhat uncontroversial reform that even the state insurance regulators support; and its resolution will save millions of dollars for brokers and consumers and, we believe, ultimately increase compliance with state premium tax requirements by resolving the conflicts that make compliance difficult, if not impossible, today. Some of the member firms of The Council have attempted to quantify the costs of regulatory compliance for multi-state surplus lines placements, and the unnecessary bureaucratic burdens add up to the millions – for individual firms. I can assure you that in my regional firm alone, countless hours are spent in the treadmill of trying to reconcile state surplus lines requirements that are unnecessary and even conflicting. Even the state regulators acknowledge this, and also acknowledge that their decades of efforts for reform (specifically, to achieve an interstate compact to govern such multi-state transactions) will not be fulfilled unless this legislation is enacted. We believe this bill offers the committee a political and substantive trifecta – lowering costs to insurance consumers, providing greater access to affordable products, and doing so with little to none of the political controversy that surrounds other federally preemptive insurance legislation. We hope that you will seize this opportunity this year.

In the balance of my testimony, I will first discuss the background of the state insurance regulatory framework that exists today. I will then focus on a broader discussion of several specific problems embedded in that current framework that together undermine competition and efficiency in the U.S. insurance marketplace while at the same time detracting from rather than enhancing consumer protection. I will then close with an overview of four reform measures we champion: surplus lines regulatory reform; “NARAB II” which would establish a national agent/broker licensure regime; the Office of Insurance Information; expansion of the Liability Risk Retention Act, and, finally (and most importantly), the National Insurance Act which would create an option federal insurance chartering regime.

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 in the last 60 years, since enactment of the McCarran-Ferguson Act, 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 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, two of the most recent 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 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. Nonetheless, 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 a couple of specific areas that illustrate some of the failings of the current regulatory system: surplus lines regulatory compliance; agent/broker licensure and regulation; speed-to-market issues; and the Liability Risk Retention Act.

Surplus Lines Regulation: A Hopeless Morass

Surplus lines insurance provides coverage for unique, unusual or very large risks for which insurance is unavailable in the admitted market. A surplus lines product is an insurance product sold by an insurance company that is not admitted to do business in the state in which the risk insured under the policy is located. In essence, the insured goes to wherever the insurance company is located to purchase the coverage. The insurer may be in another state, or it may be in Great Britain, Bermuda or elsewhere. Potential insureds can procure this insurance directly, but they generally do so through their insurance brokers. In short, "surplus lines" are: (1) insurance products sold by insurance carriers that are not admitted (or licensed) to do business in a state, (2) to sophisticated commercial policyholders located in that state, (3) for insurance coverages that are not available from insurers admitted (or licensed) to do business in that state. Surplus lines products tend to be more efficient and a better fit for commercial coverages because they can be tailored to the specific risk profiles of insured with specialized needs.

Surplus lines insurance is universally recognized as an important component of the commercial property and casualty insurance marketplace in all states, and commercial property and casualty business is done increasingly through the surplus lines marketplace.

Although the purchase of surplus lines insurance is legal in all states, the regulatory structure governing such coverage on a multi-state basis is a morass. For example: Maryland and the District of Columbia require a monthly "declaration" of surplus lines business placed, but only require payment of premium taxes on a semi-annual basis; Virginia, in contrast, requires that a declaration be filed and taxes be paid quarterly; New Jersey has 36 pages of instructions for surplus lines filings, including a page discussing how to number the filings and a warning not to file a page out of sequence because that would cause a rejection of the filing and could result in a late filing.

As a general matter, state surplus lines regulation falls into five categories: (i) taxation; (ii) declinations; (iii) insurer eligibility; (iv) regulatory filings; and (v) producer licensing and related issues.

Taxes: States have inconsistent and sometimes conflicting approaches regarding the allocation of premium taxes, which can lead to double taxation and confusion when a surplus lines policy involves multi-state risks.

- Single situs approach – 100 percent of the premium tax is paid to the insured's state of domicile or headquarter state. This approach is imposed by some states regardless of what percentage of the premium is associated with risks insured in the state. Virginia, for example, utilizes this rule.

- Multi-state approach – Premium tax is paid to multiple states utilizing some method of allocation and apportionment based upon the location of the risk(s). Because there is no coordination among the states on allocation and apportionment, determination of the amount of tax owed to each state is left to brokers and insureds. If a policy covers property insured in a single situs state and in an apportionment state, double taxation also is unavoidable. A majority of the states utilize this basic rule but the manner in which it is implemented (including the allocation formula) can vary wildly.

- No clear requirement – More than a dozen states that impose surplus lines premium taxes do not have statutory or regulatory provisions indicating the state's tax allocation method, leaving it up to the insured and the insured's broker to determine how to comply with the state law. In such states, determination as to whether any tax should be paid and whether the allocation of any such tax is permissible and appropriate is often based on informal guidance from state insurance department staff.

In addition to the near-impossibility of determining the correct allocation for surplus lines premium tax in a way that does not risk paying too much or too little tax, the differences among the states with respect to tax rates, tax exemptions, taxing authorities, and the timing of tax payments impose huge burdens on surplus lines brokers (who are responsible for paying the taxes if they are involved in the placement) and on commercial consumers, who must navigate these requirements on their own for placements that do not involve a broker and who ultimately bear the costs of not only the tax but the administrative costs of compliance in any event.

For example, state surplus lines premium tax rates range from about 1 percent to 6 percent. In one state, surplus lines taxes are levied not at the state level but at the municipality level. A member of The Council reports that in order to properly rate taxes in that jurisdiction, it must use electronic maps to determine the city and county in which a risk is located. There are hundreds of cities and counties in the state. Some counties charge a tax in lieu of the city tax, some charge it in addition to the city tax, some charge the difference between the city and county taxes, and some do not charge a city or county tax at all.

The due dates for premium taxes vary even more widely across the states. Surplus lines premium taxes are due:

- annually on a date certain in some states; the dates vary but include: January 1, January 31, February 15, March 1, March 15, April 1 and April 16;
- semi-annually in some states. Again, the dates vary but include: February 1 and August 1, February 15 and August 15, and March 1 and September 1;
- quarterly in some states (generally coinciding with the standard fiscal quarters);
- monthly in some states; and
- 60 days after the transaction in some states.

The states also differ with respect to what is subject to the tax, what is exempt from the tax, whether governmental entities are taxed, and whether brokers' fees are taxed as part of or separately from the premium tax (if they are taxed at all). As you can see, determining the proper surplus lines tax payment for the placement of a multi-state policy is a daunting task.

Declinations: Most states require that an attempt be made to place coverage with an admitted insurer before turning to the surplus lines market. Some states specifically require that one or more licensed insurers decline coverage of a risk before the risk can be placed in the surplus lines market. If it is determined that a portion of the risk is available in the admitted market, many states require that the admitted market be used for that portion of the risk.

State declination requirements are inconsistent and conflicting, and the methods of proving declinations vary tremendously, from specific requirements of signed affidavits to vague demonstrations of "diligent efforts." For example, Ohio requires five declinations, but does not require the filing of proof of the declinations. New Mexico requires four declinations and submission to the insurance department of a signed, sworn affidavit. Hawaii does not require declinations but prohibits placement of coverage in the surplus lines market if coverage is available in the admitted market. Further, Hawaii does not require filing of diligent search results but requires brokers to make such information available to inspection without notice by the state insurance regulator. In California, prima facie evidence of a diligent search is established if an affidavit says that three admitted insurers that write the particular line of insurance declined the risk. In Alabama, the requirement is much more vague. The broker is required only to demonstrate “a diligent effort” but no guidance is provided suggesting what constitutes such an effort. In Connecticut, the broker must prove that only the excess over the amount procurable from authorized insurers was placed in the surplus lines market.

Insurer Eligibility: Most states require that a surplus lines insurer be deemed "eligible" by meeting certain financial criteria or having been designated as “eligible” on a state-maintained list. Although a majority of the states maintain eligibility lists (also called “white lists”), in many of the remaining states the surplus lines broker is held responsible for determining if the non-admitted insurer meets the state’s eligibility criteria. In addition, although the NAIC maintains a list of eligible alien (non-U.S.) surplus lines insurers that is used by four states, this does not seem to have any bearing on the uniformity of the eligible lists in the remaining states. As one would expect, as a result of differing eligibility criteria from state to state – and changes in individual states from year to year – the insurers eligible to provide surplus lines coverage vary from state to state. This can make it exceedingly difficult to locate a surplus lines insurer that is “eligible” in all states where a multi-state policy is sought.

The flip side of insurer eligibility is also an issue: that is, when multi-state surplus lines coverage is placed with an insurer that is an admitted insurer (not surplus lines) licensed in one of the states in which part of the risk is located. This is problematic because surplus lines insurance cannot be placed with a licensed insurer. In these situations, more than one policy will have to be used, or the insured will have to use a different surplus lines carrier – one that is not admitted, but “eligible” in all states in which the covered risks are located.

Filings: Most states require one or more filings to be made with the state insurance department in connection with surplus lines placements. These may include filings of surplus lines insurer annual statements, filings regarding diligent searches/declinations, filings detailing surplus lines transactions, and filings of actual policies and other informational materials. Some states that do not require the filing of supporting documentation require brokers to maintain such information and make it available for inspection by the regulator.

Like other surplus lines requirements, state filing rules vary widely. Some states require signed, sworn affidavits detailing diligent search compliance; some require such affidavits to be on legal sized paper, others do not; some states require electronic filings, others require paper; some states have specific forms that must be used, others do not; some states require the filing of supporting documentation, some do not – although some of those states place the burden on the broker, who is required to store the information in case regulatory inspection is required.

Depending on the state in question, filings can be required annually, quarterly, monthly or a combination thereof. For example, several states require the filing of surplus lines information in the month following the transaction in question: Colorado requires such filings by the 15th of the month; and the District of Columbia by the 10th. Other states peg the filing date to the date of the transaction or the effective date of the policy: Florida requires filing within 21 days of a transaction; Idaho within 30 days; Kansas within 120 days; Missouri requires filing within 30 days from the policy effective date and New York 15 days from the effective date; Illinois and Michigan require semi-annual filings of surplus lines transactions. Although Illinois does not require filing of affidavits, carriers must maintain records of at least three declinations from admitted companies for each risk placed in the surplus lines market. Some states have different deadlines for different filings. Louisiana, for example, requires quarterly filings of reports of all surplus lines business transacted, and "diligent search" affidavits within 30 days of policy placement. North Dakota, in contrast, requires a single annual filing of all surplus lines transactions, and allows 60 days for the filing of "diligent search" affidavits.

In addition, some states treat "incidental exposures" – generally relatively small surplus lines coverages – differently from more substantial coverages with respect to filing requirements. States have differing definitions of what constitutes incidental exposures and who has to make required filings for such an exposure: some states require the broker to make the filings; others the insured; and some require no filings at all for incidental exposures.

Producer Licensing and Related Issues: In addition to the substantial issues outlined above, there are other vexing regulatory issues facing the surplus lines marketplace:

- Producer Licensing: All states require resident and non-resident surplus lines producers to be licensed, and all states have reciprocal processes in place for non-resident licensure. Nevertheless, there remain significant differences among some states with respect to producer licensing that can delay the licensure process, particularly for non-residents. For example, most states require that an individual applying for a surplus lines broker license be a licensed property and casualty producer. The states vary, however, as to how long the applicant must have held the underlying producer license. In addition, some, but not all, states exempt from licensure producers placing multi-state coverage where part of the risk is located in the insured's home state. In states without such an exemption, the laws require a producer to be licensed even for such incidental risks.

- Sophisticated Commercial Policyholders: Some states exempt "industrial insureds" from the diligent search, disclosure, and/or filing requirements. The definition varies among the states, but generally industrial insureds are analogous to the concept of sophisticated commercial insureds. They are required to have a full time risk manager, minimum premium requirements for selected lines of coverage, and a minimum number of employees. If an insured meets a state's criteria, the insured's surplus lines transaction is exempt from the surplus lines requirements, as provided for by the state.

- Automatic Export: A number of states allow certain risks to be placed directly in the surplus lines market. This is called "automatic export" because no diligent search is required before the risk is exported from the admitted market to the surplus lines market. As with every other surplus lines requirement, however, the states are not uniform in their designation of the risks eligible for automatic export.

- Courtesy Filings: A courtesy filing is the payment of surplus lines tax in a state by a surplus lines broker who was not involved in the original procurement of the policy. Courtesy filings are helpful when a broker places a multistate filing that covers an incidental risk in a state in which the broker is not licensed. The problem is that most states either prohibit courtesy filings or are silent as to whether they will be accepted. This uncertainty essentially requires surplus lines producers to be licensed even in states where they would otherwise be exempt.

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. Our trade association formed its first task force to work on non-resident agent/broker licensing reforms more than 70 years ago. We believe that these problems will be resolved under the provisions of the proposed National Insurance Act legislation, which would give producers a choice as to whether to stay state-based or secure a federal license to sell insurance products. Consistent with our unrelenting support for necessary reform, we likewise are supportive of the incremental reform bill (recently approved by the House Financial Services Committee's Capital Markets and Insurance Subcommittee) commonly called "NARAB II," which would create an interstate producer licensing clearinghouse.

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. 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. My firm and our individual producers hold a total of thousands of licenses and I hold several hundred, and we employ staff members whose jobs are dedicated to licensing compliance that has little to nothing to do with standards of professionalism. 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 eight 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 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, 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.

Undeniably, progress in streamlining the producer licensing process has been made since GLBA's NARAB provisions were enacted in 1999, and the National Insurance Producer Registry (NIPR) is working diligently to overcome the burdens of the various state "business rules" and additional filing requirements. 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.

As we learned with GLBA and other federal legislation, when Congress acts, the NAIC and states listen. So movement on legislation in Washington 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, in the last year, regulators have jump-started producer licensing reform efforts, and even constructively engaged with members of the House Financial Services Committee on proposed NARAB II legislation. We fully support their efforts and are working with the regulators to achieve results at both the state and federal levels.

Another important producer issue today is transparency in compensation. In today's marketplace, it is imperative that insurance intermediaries be transparent in their business dealings with their clients, and we believe there should be uniform disclosure rules and regulations. 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.

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 purpose. Moreover, it is at odds with the scope of the activities of the consumers these states are attempting to protect.

Speed-to-Market Remains a Critical Problem

The state-by-state system of insurance regulation also gives rise to problems for the carriers that directly impacts 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. While current market conditions are soft, there have been many challenges in recent years, ranging from losses 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 poor investment returns and negative underwriting results. When product availability is challenged, the current state-by-state system of insurance regulation exacerbates the problems.

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 deregulated 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 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 wrote coverage for 65 insureds. After two 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 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.

Despite recent improvements, the states clearly cannot solve the problems with insurance regulation on their own, so congressional action is necessary if insurance regulatory reform is to become a reality.

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.

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 and Benefits of Future Regulatory Options for the U.S. Insurance Industry," provides an in-depth examination of the pros and cons of the regulatory options available for oversight of the business of insurance. A copy of the study is attached to my testimony. I hope it will serve as a useful tool as you consider insurance regulatory reforms.

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.

What we are advocating 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.

Surplus Lines Regulatory Reform: The Nonadmitted and Reinsurance Reform Act, S. 929.

Sens. Mel Martinez and Bill Nelson of Florida have introduced a bill that would reform the regulation of the surplus lines market place primarily by dictating that the regulatory requirements only of the policyholder's home state would apply to any surplus lines placement. Although there are a few other bells and whistles included in the legislation, the fundamental reform would dictate that only a single set of state regulatory requirements would apply to any single surplus lines transaction. This simple reform would transform the marketplace, and is supported by all stakeholders – including the state insurance regulators themselves who believe that this type of reform is long overdue and that it can come only through Congressional intervention.

NARAB II – Fixing Agent/Broker Licensure

Legislation has been introduced in the House that would take the NARAB structure outlined in GLBA and make it into a national clearinghouse for agents and brokers that would like to use the mechanism to obtain non-resident licenses in other states. The legislation would establish a regime under which an agent/broker licensed in his, her or its home state could – upon satisfaction of the NARAB eligibility requirements which would be required to be based on the highest licensure requirements applicable in the states and which would be required to include a criminal background check – become a NARAB member and then be automatically licensed in any non-resident state upon the payment of the appropriate licensure fee. NARAB would only have a role in licensure; a state's post licensure market-conduct (include consumer unfair trade practices) requirements and prohibitions and a state's post-licensure administrative enforcement policies and procedures would continue to apply in full to NARAB members.

The Council believes that NARAB II type reforms of the state system make sense for all stakeholders and will better allow agents/brokers to better focus their attention where it should be focused – on serving their clients' needs.

An Office of Insurance Information -- Step in Right Direction

Earlier this year, the Treasury Department recommended a three-tiered, long-term approach toward radically reforming the way that insurance is regulated: first, establishment of an office within Treasury that would be a credible source of information and expertise on insurance matters, with U.S. policy on international insurance matters guided by that expertise; second, the enactment of an Optional Federal Charter; and third, movement toward an "activities-based functional system" regulating the activities of financial services firms as opposed to individual industry segments.

With respect to the first goal, legislation has been initiated in the House of Representatives that would create an Office of Insurance Information. The Office would collect data on insurance, analyze the data, and issue reports to Congress. It also would establish federal policy on international insurance matters and ensure that state insurance laws are consistent with agreements between the U.S. and a foreign jurisdiction. The Treasury Department would have a limited ability to preempt a state insurance measure that is inconsistent with an agreement regarding such policies.

The Council supports such legislation and believes that in an increasingly global world, it is essential to have a single office housed in the federal government that is capable of articulating a global policy on matters of insurance.

Changes to the Liability Risk Retention Act

During periods of hard commercial markets, insureds – particularly sophisticated commercial clients – are increasingly drawn to the appeal of alternatives to the traditional, regulated marketplace to expand their coverage options and hold down costs. Aside from surplus lines, there is an excellent mechanism that offers such an alternative: risk retention groups, created under provisions of the federal Liability Risk Retention Act. Although insurance purchased through risk retention groups technically is less regulated than insurance in the admitted market, the law currently prevents this marketplace from fully realizing its potential. Specifically, we would urge the committee to consider approving legislation that would enhance corporate governance standards for risk retention groups (as suggested by the Government Accountability Office), in addition to allowing such groups to underwrite property coverage. The House Capital Markets and Insurance Subcommittee recently approved a bipartisan bill to achieve these changes, with support from a diverse collection of organizations, including consumer groups, housing authorities, policyholders and insurance companies.

The Optional Federal Charter

The Council believes the ultimate, long-term insurance regulatory 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 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:

- ***The National Insurance Act 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.

- ***The Act 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 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.

- ***The Act 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 the Act 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, the Act leaves the state guaranty system intact to ensure 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.

Conclusion

Again, The Council greatly appreciates this opportunity to participate in this debate. We know that you, Chairman Dodd, and Senator Shelby, have been enormously effective in working together to produce good insurance legislation, such as your Federal Flood Insurance reauthorization legislation, as well as the extraordinary enactment (and revisions) of the Terrorism Risk Insurance Act. The Council has strongly supported an Optional Federal Charter, such as the one envisioned by the National Insurance Act, for decades. We look forward to being a constructive voice in this debate.

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.

Obviously, we implore the Committee to seize the opportunity to enact the Nonadmitted and Reinsurance Reform Act this year, due to the extraordinary consensus that has emerged around its basic tenants. And looking toward next year, we believe that the Optional Federal Charter is the ultimate solution to the many competitiveness issues that impact our industry. We look forward to these critical debates. Again, thank you.