STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE
July 13, 2004

Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. My name is Ronnie Tubertini, and I am pleased to have the opportunity to give you the views of the Independent Insurance Agents & Brokers of America (IIABA) on the Gramm-Leach-Bliley Act (GLBA)[1] and its effects on the insurance marketplace. I am President and CEO of SouthGroup Insurance and Financial Services, Mississippi's largest privately owned insurance agency. SouthGroup is a Jackson-based insurance agency employing 120 people in 17 locations across the State. Although based in Mississippi, SouthGroup writes business in over 20 States and provides foreign coverage for clients operating outside of the United States. My agency represents over 50 insurance companies. I am also the current Chairman of IIABA's Government Affairs Committee.

[1] Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999).

IIABA is the nation's oldest and largest national trade association of independent insurance agents and brokers. We represent more than 300,000 agents, brokers and agency employees nationwide. IIABA members are small, medium and large businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents and brokers offer all lines of insurance—property, casualty, life, health, employee benefit plans and retirement products.

Overview

The Gramm-Leach-Bliley Act,[2] signed on November 12, 1999, was the culmination of nearly two decades of effort by Congress and the financial services industry to eliminate the Depression-era laws and regulations which prevented depository institutions from affiliating with both insurance companies/producers and with securities firms. The GLBA also clarified the respective regulatory duties and powers of Federal and State regulators as these industries began to engage in each other's businesses.

We would like to focus on three parts of GLBA that directly affect insurance: (1) Title I, which facilitates affiliation between banks and securities firms and insurance companies by repealing major portions of the Glass-Steagall Act,[3] the Bank Holding Company Act of 1956[4] and other Federal banking laws; (2) Title III, Subtitle C, "National Association of Registered Agents & Brokers," which was designed to encourage the States to establish a reciprocal or uniform agent licensing system; and (3) Title III, Subtitle A, "State regulation of Insurance," which reaffirms the traditional and primary authority of the States to functionally regulate the business of insurance in the United States and clarifies the extent to which banks, or their direct

[2] Previously known as the "Financial Services Modernization Act of 1999."
[3] The Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933).
[4] The Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133 (1956).

subsidiaries, may engage in insurance.[5] Below we will describe these three aspects[6] and the effect each has had so far on the insurance marketplace in general and the independent agency system in particular. We will also discuss what lessons may be learned from them when considering potential reforms to the insurance regulatory structure.

THE EXPERIENCE UNDER GRAMM-LEACH-BLILEY

Affiliation Among Banks, Securities Firms, and Insurance Companies

Title I of the GLBA (Facilitating Affiliation Among Banks, Securities Firms, and Insurance Companies) allows depository institutions, securities firms, insurance companies and other firms engaged in financial services to affiliate under a new financial holding company (FHC) structure. Title I also provides for the supervision of these new FHCs, streamlines somewhat the pre-existing bank holding company (BHC) supervision and specifies what financial activities could be conducted directly in a bank or its subsidiary and which were required to be conducted through other non-bank affiliates within the FHC.

With the authorization of these new FHC systems, many industry experts predicted that mega-mergers among the largest players in the banking, securities, and insurance industries would transform the financial services landscape. The expectation was that convergence would lead to only a few, large diversified companies left standing to offer consumers "one stop shopping" – a smorgasborg of financial services products.

However, this has not come to pass. So far there has not been a massive move toward consolidation of the country's major financial services companies. Some mergers have occurred,

[5] GLBA Tit. I, Subtit. B, § 112 ("Authority of State insurance regulators") also confirms the responsibility of States for the functional regulation of insurance; Tit. I, Subtit. C, § 121 ("Subsidiaries of national banks") similarly restricts banks' ability to engage in insurance activities through operating subsidiaries.

[6] GLBA Tit. III, Subtit. B, ("Redomestication of Mutual Insurers") and Subtit. D ("Rental Car Agency Insurance Activities") also relate to specialized insurance issues. In addition, Title V ("Privacy") affects insurance entities as well as other financial services, but that Title makes clear -- consistent with Tit. III Subtit. A's reaffirmation of the State role -- that State insurance regulators are responsible for privacy supervision of the insurance sector.

but most have not been among the leading players -- two exceptions to that general rule being the Citicorp-Travelers Group deal, which was on the table when GLBA was enacted;[7] and more recently the Bank One purchase of key components of Zurich Life from Zurich Financial Services Group in 2003. The convergence of products and services that began in the 1980's continues to occur but through smaller and more targeted merger activity. Banks have bought individual securities firms and insurance agencies instead of insurance companies as had been predicted, and insurance companies and agencies have also begun to offer a wider variety of products.

Banks have been reluctant to get into the insurance business, the underwriting side if not sales, for a couple of reasons. First, the insurance industry typically has a lower return on equity than the rest of the financial services industry. Over the last decade, diversified financial firms have earned nearly a 20 percent rate of return, banks around 15 percent, and insurance companies generally between 5-10 percent. Put simply, acquiring insurers oftentimes does not make economic sense for banks.

Second, there is philosophical conflict between the two industries and, it seems, limited opportunity for synergies. Banks are by nature risk averse and the insurance industry is inherently volatile and risky. After all, insurance at its core is the aggregation of risk. The insurance marketplace differs from most other financial services in that insurers must price and sell their policies *before* the full cost of coverage is known. This is especially true in the property/casualty marketplace where insurers must try to anticipate losses such as catastrophic exposures like earthquakes, hurricanes, and now terrorism. Insurer results are also whipsawed by unexpected changes in the legal system, such as Superfund or asbestos-related expenses,

[7] It should be noted, however, that in 2002 Citigroup spun off Travelers Property Casualty Group while retaining Travelers Life and Annuity Company.

which can have a negative effect on company surplus. Property/casualty insurers typically break even or lose money on their underlying business, the underwriting of risk -- that is before investment income is taken into account. The first half of this year was only the second time the U.S. property/casualty industry has posted a collective underwriting profit since 1986. It appears that banks are not willing to use available capital to get into underwriting insurance as it is a very complicated and difficult business.

Banks have been more inclined to get into the sale of insurance through the acquisition of insurance agencies; however, this trend has not been overwhelming. According to the *Financial Services Fact Book 2004*,[8] banks acquired 60 securities firms and 74 insurance agencies in 2002[9] (latest data available). While the number of bank purchases of insurance agencies increased in 2002 by 17% from 2001, the value of those deals decreased in that same year by 68%.[10] In fact, the number of bank/agency deals in the period from 1999 - 2002 has remained relatively constant with 66 in 1999, 77 in 2000, 63 in 2001, and 74 in 2002.[11]

On the flip side, more insurance trade associations and a few individual carriers have now entered the banking market. This has come more in the form of applications for thrift charters to open new OTS-supervised banks instead of buying existing banks. Examples of insurers -- or their trade associations -- wading into the banking market are the National Association of Mutual Insurance Companies, State Farm and Metlife. The IIABA has done the same with InsurBanc, the Federal savings bank developed jointly by the IIABA and the W.R. Berkley Corporation to serve independent agents and brokers as well as their clients. InsurBanc opened on April 30, 2001. Three years later, InsurBanc has more than $32 million in deposits and $60 million in

[8] Insurance Information Institute and the Financial Services Roundtable, *The Financial Services Fact Book 2004* (Dec. 15, 2003), *available at* www.financialservicesfacts.org. ("*FS Fact Book*")
[9] *Id*. at V
[10] *Id*. at 76
[11] *Id*.

assets, including the investment of nearly $30 million in agency-related loans.[12] Along with agency financing products and services, InsurBanc offers working capital lines of credit, commercial term loans and commercial real estate loans. InsurBanc also provides an array of consumer banking products that agents and brokers can offer to their clients, including consumer loans, credit cards, home equity loans, mortgages, certificates of deposit, and money market accounts.

While the mega-mergers that some envisioned have not occurred, consolidations within most financial services sectors have boosted the market share of the largest players in those sectors. This trend, which began in the mid-1990's, has continued in this decade for the insurance industry. From 1996 to 2002 the market share of the top 10 companies grew from 38 to 51% in the life/health insurance market and from 35 to 55% in the property/casualty marketplace.[13]

As life insurers, who are perhaps the most challenged by product convergence from non-insurance players, attempt to diversify their revenue streams and gain economies of scale, further consolidation among the remaining 1,462 U.S. life/health insurers is expected.[14] One commentator predicts that the market share of the top 10 life insurers will approach 75% by the end of the decade.[15] Continued consolidation is also anticipated in the property/casualty industry. Some expect the number of U.S. property/casualty insurers, now numbering approximately 3,300, to fall by 30% over the next decade.[16] With the fractured capital that this current large number of players in both the life/health and property/casualty industries represents

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[12] For more information on InsurBanc's products and services, go to www.insurbanc.com.
[13] *FS Fact Book* at V.
[14] Meg Green, *Bulking Up,* BEST'S REVIEW, July 2004, July 2004, at 22-23
[15] *Id*.
[16] *FS Fact Book at 1.*

and the inherent volatility of the business, it is perhaps not surprising that return on equity has been lower for insurance underwriters than the rest of the financial services industry.

Industry experts are currently divided on whether the industry consolidation will occur through large companies merging with or making wholesale acquisitions of others (e.g. the St. Paul Cos.-Travelers Property Casualty deal of 2003) or insurers taking only selected bits and pieces of other companies in the form of purchases of specific lines or blocks of business. Regardless, the result is largely expected to be the same: increased consolidation in the insurance marketplace.

The independent agency system has followed the overall insurance industry trend towards consolidation. In 2002 (latest data available) there were 192 announced mergers and acquisitions in the agent/broker community. The number of deals has remained relatively constant over the five year period from 1998 to 2002 with 184 deals in 1998, 235 deals in 1999, 188 deals in 2000, and 179 deals in 2001.[17] This however involves a relatively small number of all independent agencies, which continues to be a principal form of p/c insurance product distribution.

National Association of Registered Agents and Brokers (NARAB)

One of the most significant accomplishments of GLBA for the insurance marketplace was the NARAB Subtitle, which launched a producer licensing reform effort that continues today. Prior to the enactment of GLBA, each State managed its agent/broker licensing process in a distinct and independent manner, and there was virtually no consistency or reciprocity among the States. For agents and brokers, who increasingly operate in multiple jurisdictions, the financial and paperwork burdens associated with multi-State licensing compliance became overwhelming; and consumers suffered as duplicative and redundant regulatory requirements

[17] *FS Fact Book at 3.*

made it difficult for producers to be responsive to their needs. However, insurance producer licensing has improved dramatically over the last five years, and these changes are a direct result of Congress' decision to address these issues in Subtitle C.

The Subtitle put the ball in the States' court by threatening the creation of a new national, NASD-style licensing entity – known as the National Association of Registered Agents and Brokers – if the States did not satisfy the licensing reform objectives articulated by Congress. The creation of NARAB was only averted when a majority of the States and territories (interpreted to be 29 jurisdictions) achieved a specified level of licensing reciprocity within a three year period.

To their credit, the National Association of Insurance Commissioners (NAIC) and most States took swift and unprecedented action in response to "act-or-else" licensing provision. Nearly every State enacted new legislation that established licensing reciprocity among the States and instituted interstate uniformity in certain critical areas. According to the NAIC, at least 48 States have passed licensing reform legislation since the enactment of GLBA, and over 40 jurisdictions have been formally certified as meeting the NARAB mandates. There is no dispute that the NARAB provisions had their intended effect and initiated the move toward licensing modernization at the State level. Although more improvement is undoubtedly needed, the States have made significant progress in the five years since the passage of GLBA.

The success of the NARAB licensing provisions is a perfect example of what the Federal government and the States can accomplish in partnership and how Congress can assist the States to achieve much needed marketplace reforms. The NAIC and State policymakers had been trying to move toward reciprocal and uniform licensing for over a century, but little progress was made until Congress set a specific deadline and attached specific goals and repercussions. In fact, Congress set the bar at only a majority of the States and now all but a handful of States have met the NARAB reciprocity standard. This success would not have occurred without targeted Federal legislation, or what some are now calling "Federal tools."

Some may argue that the bar was not set high enough -- because uniformity was not required and several States have not adopted the reciprocity standards -- but there is no arguing with the provision's effectiveness so far. There is certainly much more to do to get to full agent licensing reciprocity and the ultimate goal of licensing uniformity, but NARAB has set State insurance regulators on the right path, and Congress can now easily move the bar higher in follow-up legislation.

Functional Regulation – State Insurance Regulation

Perhaps the most important accomplishment of GLBA in protecting insurance consumers was its focus on functional regulation. The concept of functional regulation provides that insurance regulators oversee the business of insurance, banking regulators oversee banking activity, and securities regulators likewise are responsible for securities activity. GLBA specifically reaffirmed the traditional authority of the States to regulate the business of insurance in the United States.

GLBA expressly states that the McCarran-Ferguson Act[18] remains the law of the United States and further states that no person shall engage in the business of insurance in a State as principal or agent unless such person is licensed as required by the appropriate insurance regulator of such State. Title III also 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 new affiliation policy adopted in Title I of GLBA.

[18] McCarran-Ferguson Act, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§1011-1015 (1994))

These provisions collectively ensured that State insurance regulators retained regulatory authority over all insurance activities, including those conducted by financial institutions and their insurance affiliates. Title III also provided for expedited judicial review of disputes between State officials and Federal financial regulators, with the courts being directed to give equalized deference to the rulings or actions of both the States and the Federal regulator. These mandates were intended in large part to draw the appropriate boundaries among the financial regulators, boundaries that unfortunately continue to be challenged.

Since GLBA codified this important principle, the focus has largely shifted to the success of functional regulation in the insurance marketplace and the effectiveness and efficiency of State insurance regulation. The discussion has taken on more urgency as the perceived need for regulatory reform has increased due to the emergence of a more global financial services industry.

From the beginning of the insurance business in this country, it is the States that have carried out the essential task of regulating the insurance marketplace to protect consumers. The current State insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851, and insurance regulators' responsibilities have grown in scope and complexity as the industry has evolved. When a Supreme Court decision raised questions about the role of the authority of the States, Congress quickly adopted the McCarran-Ferguson Act in 1945. That act, which was reaffirmed by Congress five years ago, declared that States should regulate the business of insurance and that the continued regulation of the insurance industry by the States was in the public's best interest.

Most observers agree that State regulation has worked 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, the purchaser of an insurance policy will not be able to fully determine 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. As a result, insurance is a product with which consumers have many issues and questions and if a problem arises they want to resolve it with a local call. During 2001, State insurance regulators handled approximately 3.6 million consumer inquiries and complaints. Today, State insurance departments employ approximately 13,000 individuals who draw on over a century-and-a-half of regulatory experience to protect insurance consumers.

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. When property, casualty, and life claims arise, their legitimacy and amounts must be determined according to individual State legal codes. 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 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 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. The system has paid out over $11 billion to cover claims asserted against insolvent insurers since they were first created in the mid-1970s. 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.

Despite its many benefits, State insurance regulation it not without its share of problems. The shortcomings of State regulation of insurance fall into two primary categories—it simply takes too long to get a new insurance product to market, and there is unnecessary duplicative regulatory oversight in the licensing and post-licensure auditing process.

In many ways, the "speed-to-market" issue is the most pressing and the most vexing from both a consumer and an agent/broker perspective because we all want access to new and innovative products that respond to identified needs. The reality of today's marketplace is that banking institutions and securities firms are able to develop and market new and more innovative products and services quickly, while insurance companies are hampered by lengthy and complicated filing and approval requirements in 50 States. As a result, insurance companies — and, derivatively, agents and brokers selling their products and services—are at a competitive disadvantage compared to their counterparts in other financial services sectors.

Today, insurance rates and policy forms are subject to some form of regulatory review in nearly every State, and the manner in which rates and forms are approved and otherwise regulated can differ dramatically from State to State and from one insurance line to the next. Such requirements are significant because they not only affect the products and prices that can be implemented, but also the timing of product and rate changes in today's competitive and dynamic marketplace. The current system, which may involve seeking approval for a new product or service in up to 55 different jurisdictions, is too often inefficient, paper intensive, time-consuming, and inconsistent with the advance of technology and regulatory reforms made in other industries. Cumbersome inefficiencies create opportunity costs, and the regulatory regime in many States is likely responsible for driving many consumers into alternative market mechanisms. In order to keep insurers competitive with other financial services entities and maximize consumer choice in terms of the range of products available to them, changes and improvements are needed.

Similarly, insurers are required to be licensed in every State in which they offer insurance products, and the regulators in those States have an independent right to determine whether an insurer should be licensed, to audit its market-conduct practices, to review mergers and acquisitions, and to dictate how the insurer should be governed. It is difficult to discern how the great cost of this duplicative regulatory oversight is justified.

IIABA's Support for the NARAB Approach of Targeted Reforms

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 are opposed to any form of Federal regulation, optional or otherwise. Yet despite this historic and longstanding support for State insurance regulation, we are not confident that the State system will be able to resolve its problems on its own. For the most part, 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.

Therefore, IIABA believes that there is a vital role for Congress to play in helping to reform the State regulatory system, but that such an effort need not replace or duplicate at the Federal level what is already in place and successful at the State level. 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 the IIABA as our members represent consumers in the insurance marketplace.

IIABA believes the best alternative for addressing the current deficiencies in the State-based regulatory system is a pragmatic, middle-ground approach that utilizes Federal legislative tools to foster a more uniform system and to streamline the regulatory oversight process at the State level. By using targeted and limited Federal legislation to overcome the structural impediments to reform at the State level, we can improve rather than replace the current State-based system and in the process promote 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 increasingly global marketplace. There are only a handful of regulatory areas where uniformity and consistency are imperative, and Congress has the ability to address each of these core issues on a national basis in a single legislative act.

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.

The enactment of targeted Federal legislation to address certain, clearly identified problems with State regulation is not a radical concept. The Senate Banking Committee and the House Financial Services Committee have already proven that this approach can work with the NARAB provisions of GLBA that we have already discussed. The IIABA believes the NARAB model can serve as a template for further reform of State insurance regulation. The leadership of the House Financial Services Committee has recently decided to take the NARAB approach of "targeted reform" after conducting a three-year in-depth review of insurance regulation. We understand the Senate Banking Committee still has much to consider on this subject and the IIABA looks forward to working with you in any review of State insurance regulation and potential reforms that the Committee may conduct.

Conclusion

In conclusion, we can say that the GLBA has not fundamentally altered the insurance landscape for consumers. While the consolidation within the insurance marketplace that began in the 1990's has continued and perhaps increased, the mega-mergers of financial services providers that were expected have generally not occurred. GLBA reaffirmed the authority of the States to functionally regulate insurance, and led to substantial reform in the multi-State licensing of agents and brokers through the NARAB Subtitle. This was an important precedent in insurance regulation that Congress can look to in the future.