Statement of

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On behalf of the

Property Casualty Insurers Association of America

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Introduction

Chairman Shelby, and other members of the committee, I am Jaxon White, Chairman, President and Chief Executive Officer of the Medmarc Insurance Group. I am a member of the Board of Governors of the Property Casualty Insurers Association of America ("PCI") and I am here today to present the association's views regarding regulation and competition in the insurance industry. I appreciate the opportunity to appear before the committee.

PCI has been a supporter of the state regulatory system. We remain hopeful that the current system can be reformed to address the many problems our members encounter. However, since the current federal discussion and consideration of insurance regulatory reform began in 2002, we have not seen substantive, meaningful reform in state regulation. We still would like to see such change and stand ready to work with the states to accomplish reform. It just has not happened.

PCI Reflects the Views of the Broad Industry

The mission of PCI is to foster a healthy, well regulated, and competitive insurance marketplace that provides both personal and commercial insurance consumers the opportunity to select the best possible products at the best possible prices from a variety of competitors. PCI provides a responsible and effective voice on public policy questions affecting property/casualty insurers and the millions of consumers we serve.

PCI is uniquely positioned to speak to issues concerning insurance regulation. PCI members write nearly 40 percent of all the property/casualty insurance written in the United States, including 49.5 percent of the nation's auto insurance, 38.3 percent of the homeowners policies, 31.5 percent of the business insurance policies, and 40.2 percent of the private workers' compensation market.

The insurance industry is very complex, given the myriad of products and the ways in which insurance products reach the consumer. PCI reflects that variety in its membership and, as such, is well suited to say if a given proposal addresses the full complexity and needs of the industry.

PCI members are stock, mutual, reciprocal and lloyd's in form. Our members write on an admitted and surplus lines basis and as risk retention

groups. Products are distributed through: agents, captive, employees, independent agents, brokers, surplus lines brokers, managing general agents, and directly to the consumer via telephone, internet, and company direct mail. Our members are national, regional, single state in their company scope, and range in size from the very small to some of the largest and most well-known insurers in the country. We represent multi-line writers, personal lines-only writers, commercial lines-only writers, specialty writers and monoline writers. PCI members write all lines of business in every state.

For the last 21 years, I have served as chief executive officer of the Medmarc Insurance Group. Our core products are products liability and general liability, targeted primarily to manufacturers and distributors of medical devices and life science products. Interestingly, I serve an industry that is itself federally regulated. We also write lawyers' professional liability in 24 states and the District of Columbia.

While my personal experience and that of Medmarc is not as broad-based as that of PCI, our experience crosses a number of disciplines in the insurance world. Our group consists of three property casualty writers and an insurance agency. The parent company is mutual in form. Its three subsidiaries are all stock companies, domiciled in different states.

Many would consider Medmarc to be a small organization, but not insignificant in size. Our 2005 direct premiums were over $100 million, with $66 million in net premium. We write on both an admitted and a surplus lines basis in all states and the District of Columbia. We are subject to myriad filing and reporting requirements for our admitted companies in 51 jurisdictions to maintain our ability to do business and to bring our products to market. Financial reporting to regulators is done on a quarterly and annual basis and statistical, actuarial and other reports are filed routinely throughout the year. This translates into hundreds of filings made for each company, every year. There are also reporting requirements for our surplus lines company and, contrary to what some might say, surplus lines is not free from regulation.

Consumers

Insurance regulation affects more than just the insurers who operate under these rules. Consumers are directly affected by the regulatory environment,

since it controls the products they receive, the financial solidity of their insurer, and, in many cases, the price they pay. Overzealous or unnecessary regulation harms consumers when it restricts competition and limits consumer choice. Others with a stake in the system include lenders desiring a degree of protection for assets, investors, and the community as a whole. Most important, the regulatory environment can have a significant impact on the states' and the nation's economy, since the financial protection afforded by insurance minimizes and manages risk and encourages businesses to expand and create new jobs.

PCI Members Support Competitive Markets for Consumers and a Regulatory Focus on Solvency Protection

Despite the diversity of PCI's membership, all our members share the common vision that consumers are best served when markets are free, fair, competitive, and fairly regulated. Consumers in those states where regulation fosters a healthy competitive environment have the greatest number of product choices and the most competitors offering those choices. They benefit as well by having a system that allows products to respond swiftly to changes in their needs. PCI also believes market-oriented regulation frees up regulators and regulatory resources to focus on the most important regulatory function: ensuring that the real promise of insurance - that the insurer will be there to pay a claim – is always met. In other words, to focus on strong, sound solvency regulation.

The Regulatory System Imposes Needless Opportunity Cost and Limits Consumer Choice

One of the inherent problems with the current system is the continued inconsistency of the regulatory environment from state-to-state. State regulation remains a patchwork quilt of inconsistent rules and regulations, making it difficult for companies to operate in some markets, increasing the cost of regulatory compliance, and reducing the amount of choice, both in terms of companies and products, that consumers have.

To the extent consumers cannot obtain products they need, they bear an important opportunity cost as needs for financial protection remain unmet or are addressed in less efficient ways.

Insurers, too, bear an important opportunity cost when unnecessary regulation prevents a product from being brought to market quickly and efficiently. Regulation reform that eliminates such obstacles avoids such important opportunity costs and benefits consumers. Capital is limited and companies in any industry will consider entering markets that provide them the best opportunity to earn a fair return on investment. The regulatory environment has a significant impact on these business decisions and in the last four years, we regret to say that we have not seen that environment get significantly better.

The concept of opportunity cost is clear when comparing the situation where similar products are offered by the banking industry and insurance industry. The concept of speed to market rests on the idea that banks are able to quickly offer products that are responsive to an expressed market need, usually without prior product approval by a regulator. A competing insurer, offering a similar and competitive product, is at a disadvantage in having to wait for state approvals in order to introduce the insurer's new, similar product. The same situation exists even without comparison to the banking industry when an insurer is prevented from gaining approval of product improvements, modifications or new product offerings in an efficient and timely manner. Market opportunities do not last forever and the regulatory approval process can and does significantly stifle the introduction of new products and services. Consumers pay these costs in the form of reduced competition, higher prices and fewer products from which to choose.

Consumers Ultimately Bear Unnecessary Costs

Consumers are also hurt by the fact that they inevitably bear the burden of the systemic costs of needless regulation. As is true in any market economy, the costs of producing a product or service are borne by the consumer, including the cost of regulation. In our view, consumers should only bear the cost of necessary regulation, not needless regulation. Much of the regulatory structure today is needless, given the highly competitive nature of our industry. Over the past four years, we have certainly seen efforts by the states at making incremental improvements in the system, but these have been more of form than of substance.

As Congress considers the insurance regulatory system and various proposals for reform, PCI recommends that any proposal be examined in light of the costs that would be passed on to the consumer. We urge you not

to forget that some reform proposals may add significant costs of regulatory overlap or dual regulation onto consumers. Or a system might place an additional burden of regulation by the courts, adding a cost of litigation to the true cost of regulation. Or, as is currently the case, a proposal may impose costs arising from a lack of uniformity across the states or create regulatory diversions that make the regulatory system unable to focus on the most critical element of insurance regulation, solvency.

In summary, PCI believes that consumers want good, responsive products at a reasonable price offered by companies who pay claims when they are owed. Restrictive or obsolete regulations which erect barriers to entry, impose inappropriate costs, or limit product availability and innovation only burden the system and harm consumers. An effective regulatory system should result in greater choice, convenience and innovation for the consumer.

Competition Should Be the Cornerstone of Reform

The cornerstone of any regulatory modernization effort must be modernization of rate and form filing requirements. While we have seen some improvements in some states in the last few years, we do not believe these efforts have gone nearly far enough or resulted in nearly enough change on an aggregate basis.

This is an issue I've dealt with firsthand. My own company, as well as all other PCI members, finds the current system too complex, to expensive, and too uncertain. We never know when we will be able to bring a new product "on-line" – or even if a state regulator will allow us to do so. This limits our ability to adapt to changing market conditions and restricts our ability to compete.

As we developed our company, we found that our normal profit planning became very difficult as did our ability to do business in a state. To us, rate and form requirements in the states where we wanted to do business were so bad that we made the business decision to purchase a surplus lines insurer, free of significant elements of rate and form regulation, rather than attempt to run the gauntlets of state approvals. This was a solution that worked for us, but the nature of the business for other insurers may leave them unable to adopt such a plan due to their unique circumstances.

What has happened in the last four years?

The most recent round of discussions regarding state regulatory reform began about four years ago. Since then, there have been numerous hearings, both in the House and Senate. PCI testified on March 31, 2004 before the House Financial Services Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee stating:

> "Meaningful reforms that reflect the way business is conducted and are adaptable to the changing business environment must be adopted. Current regulatory systems frequently cause delays in new products offerings for consumers and impose needless, and costly, rate approval processes. In some states, the company and agent licensing processes are also lengthy and cumbersome. Conversely, in other states, the market withdrawal process is bureaucratic and punitive in nature. Financial and market conduct examinations are often disjointed and inefficient, and suffer from a lack of coordination. These areas of state regulation must be improved and simplified and greater uniformity must be achieved."

PCI members are disappointed by the poor track record of the states toward those meaningful reforms in the last four years. Some procedural progress has been seen, but even these procedural changes place new burdens on insurers in states that otherwise would not impose the burden, but for the desire for uniformity of procedure. Stated another way, we have seen some change in form, not always clearly for the better, and little change in substance.

Despite the efforts of a number of states to modify the rate and form filing requirements toward a more open market, on an aggregate basis, the regulatory landscape in the states remains virtually unchanged for the last four years.

There is no uniformity across state lines as states still differ significantly on how property/casualty rates and forms are regulated. Even within a state, different lines of business continue to be regulated differently. Insurers still must submit personal lines policy forms for review and approval in over forty states before the forms can be used. For personal lines rates, insurers can submit rates on a file and use basis in approximately thirty states, while

the remaining number of states are primarily prior approval. Implementation of “file and use” may sound like an improvement, but there are significant lead time requirements with file and use that an insurer must adhere to prior to releasing a product into the market. Also, many insurers feel it safer to treat "file and use" as *defacto* prior approval because of potential retroactive disapprovals and requirement that the insurer must disgorge any profits made during the period.

Approval remains the determining element in all filing methods, whether prior approval, file and use or use and file. The result is political manipulation ranging from outright disapproval to disapproval of rating plans, rating factors, discounts and territorial rating. Rates no longer reflect true risk of loss, but rather a system of subsidies, unjustly higher rates for some, and a stifling of competition. The consumer continues to lose.

There is less restrictive regulation on the commercial lines side, but given the multi-state nature and the commercial savvy of those insureds, much more streamlining is needed, but has not happened.

Most states allow commercial policy forms to be submitted under file and use rules. However, commercial insurers have the same concern with "file and use" regarding retroactive disapprovals. “Speed to market” does not really exist, as companies must wait to receive approvals before using their products. Many commercial risks operate in a multi-state environment with needless regulatory complexity for both the business consumer and the insurer. To meet the needs of multi-state commercial risks, insurers need to secure approval of a new or revised commercial policy form and the corresponding rates in the majority of the states before the product can be implemented for the multi-state insured.

It is true that some states have continued to pursue a bona fide regulatory modernization agenda, but those are few in number and limited in scope. For example, South Carolina enacted legislation as follows:

- In 1999, a flex rating system for auto was implemented.
- In 2000, South Carolina eliminated prior approval rate requirements for commercial policies with a threshold of $50,000 in premium or more. In 2002, the premium threshold was removed.
- In 2004, legislation was enacted implementing flex-rating for homeowners.

Other states have taken some steps toward improving the regulatory review process. For example, Maryland in 2000 implemented a rate filing exemption for the large commercial risk with a premium threshold of $75,000. In 2006, the premium threshold was reduced to $25,000. Other states have similarly implemented or expanded exemptions for large commercial risks. But not all states have exemptions for large commercial risks and thresholds for determining the exemption vary greatly by state. It still is difficult if not impossible for an insurer to place, with certainty of compliance, a multi-state exempt risk.

As to some particular states, we have seen positive auto reforms in New Jersey and some progress in flex rating in Connecticut, but flex rating is an incremental progress. However, in the Massachusetts auto insurance market, perhaps the nation's most restrictive regulatory environment, the only progress has been discussion and bill introduction to reform the auto market. It remains a state in which the number of auto insurers doing business is significantly lower than is typical in the states throughout the nation. At this point, we have to say that we hold slim hopes of passage of meaningful auto insurance reform in the near term.

The NAIC and the states joining the compact are to be commended for progress regarding the life insurance compact. However, progress on property & casualty rate and form filing requirements has been limited to the implementation of State Filing Review Requirements Checklists and the System for Electronic Rate and Form Filing (SERFF). But SERFF is procedural, not substantive, as to a company's ability to use a rate or a form. The majority of the states are accepting SERFF filings for property/casualty but not all lines in all states. Per the SERFF web site, only 302 filings were processed via SERFF in 1998. In 2005, 183,362 SERFF filings were processed. Even with SERFF, Florida has developed its own electronic filing system in order to meet its own internal processing needs.

SERFF is only an electronic delivery system for filings, addressing process, but it does not significantly assist with true speed to market as the actual approval process remains. The implementation of the checklists combined with the SERFF tool do nothing to address the underlying law or the cultural practices and desk drawer rules that some state insurance departments have institutionalized. These tools do not address the varying requirements among states nor do they address variances among state analysts in the same insurance department.

Promulgation of filing checklists is a procedural improvement. As of July 1, 2006, all states with the exception of five have developed and published state filing requirements checklists for property and casualty lines of business. That is all they are, however, checklists regarding filing.

In the area of company licensing, my company chose to buy an admitted carrier as we did not believe in 1995 that we could be licensed in all states within five years. I am not certain that my opinion would change today. The NAIC has made procedural progress with the Uniform Certificate of Authority Application (UCAA) to cut the red tape of applying for a certificate. However, in doing so, the UCAA, in order to accommodate each state's unique requirements, made the requirements additive of numerous differing state requirements, or the "highest common denominator" by including many individual state requirements so that the application contains many items that many states do not use or consider in the application process. This is not better regulation, only an amalgam of each state's requirements. On the substantive side, there were provisions encouraging states to respond by a certain date to applications. In practice that is not always followed so that an insurer cannot plan a date by which it can reasonably expect to be able to do business in a given state. Finally, some states continue their unique requirements. I'm not sure if this is reflective of better state regulation or not, but one PCI member indicated that, for their company to implement a multi-state corporate name change, it took one year. In and of itself, an improvement, but given that this is only a change of name, much too long a time to implement so simple a change.

It is necessary here to talk about "desk drawer" rules. These are regulatory rules that have not been codified or formally adopted through regulatory proceedings. Insurance companies are not in a position to know what the desk drawer standards are in advance, and they are used by states with applications for a license, in rate or form filings or in market conduct examinations. Companies are not kept abreast of revisions, should they occur as these rules are unwritten. In fact, the authority for these standards is often lacking or questionable. Applications of these unpublished and unpredictable procedural requirements often serve as barriers to market entry and thwart the efforts of insurers to offer new products and services for consumers.

As to producer licensing, the NAIC and the states did move quickly toward reciprocity to avoid NARAB, but this was due to the pressure from the Gramm Leach Bliley Act. There has been some streamlining of procedures regarding licensing including a uniform application. However, as a practical example, procedures for handling something as simple as a producer's change of address have not yet come "on line." Nor has there been real movement toward uniformity of licensing.

In the area of market conduct, as a businessman, one thing I look for is certainty and predictability of outcomes. We can adapt to requirements, hopefully fair, that are set before us. But in the area of market conduct examinations, we have not seen a movement toward consistency and clarity. Desk drawer rules are often used to critique a company. Examinations are often neither targeted at insurers with evidence of market conduct problems, nor are they always coordinated to minimize expense to the company. One aspect of market conduct examination has actually gotten worse. PCI has seen a rise in the use of "contract examiners" who bring to the process an inherent conflict of interest in that it is in their interest to extend examinations upon the insurers for whose examination they will be paid, ironically, by the insurer.

Further Considerations

Even considering where the regulatory system stands today and of the lack of progress in reform over the past four years, PCI strongly urges Congress to move with caution in considering changes to insurance regulation. PCI supports the state regulatory system and we would like to see state system improved. Any reform proposals must take into account that insurance is a major part of the US economy and a complex market that has evolved over time. We urge careful consideration of potential unintended consequences of changes before any actions are taken.

We believe the best place to start the debate is to define the principles of a good regulatory system, determine what such a system should accomplish, and then determine how best to correct the flaws in the current system. PCI is looking at various models of business regulation, here in the U.S. and abroad in an effort to build such a regulatory model. For example, one question is, should "principle based regulation" rather than "rules based regulation" be the standard for financial regulation and would the concept be exportable to insurance regulation in other areas or in general? We have

also spoken about various areas of insurance company operations. As we examine the regulatory system, we will be looking at those areas to determine what might define “good regulation” of those activities. We urge Congress and anyone else looking at insurance regulation to do the same.

As you continue your review and consideration of these issues, we look forward to working with you and offering our perspectives on the proposals you will consider. PCI offers a reflection of the considered views of the breadth of the insurance industry.