INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR U.S. CONSUMERS, BUSINESSES, AND JOBS

HEARING

BEFORE THE

SUBCOMMITTEE ON
INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

JULY 28, 2011

Printed for the use of the Committee on Financial Services

Serial No. 112–53

U.S. GOVERNMENT PRINTING OFFICE

67–948 PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR U.S. CONSUMERS, BUSINESSES, AND JOBS

Thursday, July 28, 2011

U.S. House of Representatives,
Subcommittee on Insurance, Housing
and Community Opportunity,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Capito, Garrett, Dold, Stivers; Gutierrez, Cleaver, and Sherman.

Also present: Representative Green.

Chairwoman Biggert. This hearing of the Subcommittee on Insurance, Housing and Community Opportunity of the Committee on Financial Services will come to order. I would like to welcome the witnesses here today.

We will begin with our opening statements, and I will yield myself 4 minutes.

Good morning and welcome to this hearing entitled, "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses, and Jobs." And I certainly welcome today's witnesses.

Today, we will hear testimony that covers much ground, ranging from a number of domestic Federal, and State regulatory initiatives to international initiatives, including congressional ratification of three pending free trade agreements.

For over 150 years, the U.S. insurance industry has been a growing and vibrant source of financial security for millions of Americans. Insurance companies of every kind including life, property, casualty, auto, health, and reinsurance have been regulated primarily by the States with Congress occasionally reviewing that State-based system to ensure uniformity and effectiveness.

The McCarran-Ferguson Act of 1945 maintained the States' regulatory authority over insurance unless a Federal law expressly provides otherwise, such as flood and terrorism insurance. All that changed with last year's passage of the Dodd-Frank Act.

For example, the Dodd-Frank Act created the Financial Stability Oversight Council, or FSOC as we call it, charged with designating which financial firms are too-big-to-fail. The FSOC has done nothing but create uncertainty for the financial services industry, especially for insurers.

In fact, I have heard from many insurers that they are not expanding their companies and creating jobs because over 1 year after Dodd-Frank became law, it is still unknown what FSOC and the Federal regulators could do to their business.

The Dodd-Frank Act also required regulators to establish what was known as the Volcker Rule, which some proponents claim will curtail speculative trading and investments that amount to gambling by financial services firms.

However, many insurers traditionally invest for the purpose of avoiding risk. These insurers fear that they may be subject to a new Volcker Rule that limits their ability to hedge against risk. These are a couple of examples of the broad array of uncertainties the Dodd-Frank Act has created for the insurance industry.

On the domestic front, Federal and State officials as well as the private sector must coordinate and redouble our efforts to help our U.S. insurers by facilitating streamlined, less burdensome and costly, but more effective regulation.

Does that mean insurance should be federally regulated? I would say, no. The State-based system of insurance regulation has worked and endured. Some would say it has even thrived during the harshest of conditions and during this most recent financial and economic crisis.

Our goal is to ensure that any financial regulatory measures do not: one, lead to fewer choices and higher costs for consumers; two, hamstring businesses so that they cannot expand; and three and most importantly, prevent businesses from creating desperately needed jobs.

Regulation at any level, Federal or State that is duplicative, burdensome and costly should be strongly reconsidered. I encourage today's witnesses to think seriously about working together to find common ground instead of continuing to compete against each other where no one wins.

As for U.S. insurers' position in the global market, it is up to us. I truly believe that if the President can transmit the free trade agreements to Congress, if Federal officials, State insurance regulators, and the industry can develop unified positions on insurance standards and regulations, and if the United States can soon fully engage with the international community, our insurers will be competitive.

I hope that today's hearing will review what action or inaction Federal and State regulators and perhaps Congress should consider taking to bolster U.S. insurance for the benefit of consumers and businesses but also to facilitate job creation.

With that, I yield to the ranking member, Mr. Gutierrez from Illinois, for his opening statement.

Mr. GUTIERREZ. Thank you.

Thank you, Chairwoman Biggert, for holding this hearing on insurance oversight. And I would like to welcome our witnesses today.

Of course, there are many who would like government to just disappear until they need $700 billion to get bailed out.

There are always those who say that less regulation, no regulation at all would make the economy prosper. So, if we would disappear, everything would be just hunky-dory.

I don't know if that is exactly true, but I understand it. Everybody wants less regulations because they want higher profits; I get that part.

But I think we also have to make sure that American consumers are well served. So I think we need to find that balance and I am certainly always going to try to seek that balance out between the needs of the business community and the needs of American consumers that sometimes are on a path and collide with one another—their self-interest.

But I do want to say to the chairwoman that I think that one size probably doesn't always fit all and that not all financial institutions that are $50 billion or greater, or whatever amount you want to make, are identical or would create the same kinds of risk to our markets—at least systemic risk to our markets.

I look forward to looking at—and I think particularly insurance companies don't present the same kind of risk, although they may be larger and they may be in the hundreds of billions of dollars. An annuity is a different way of holding risk—life insurance is another kind, and the manner in which they judge their risk.

So, I think there is merit to looking at how it is we move forward. And I think that all legislation should be up for review including what I supported very vigorously, the Frank-Dodd Act.

That is one area where I hope I can work with Chairwoman Biggert in making sure that we don't put cumbersome regulations or statutory regulations on institutions that we really figure don't need them. So, I look forward to working on that.

When we passed the Wall Street Reform Act last year, we included very important provisions to create a Federal Insurance Office, or FIO, and among the duties tasked is the ability to receive and collect data, something that had been previously lacking among State insurance regulators.

The law also included a provision that directs FIO to coordinate with each relevant agency and State regulator to determine if the information to be collected is available and may be obtained from other agencies before collecting data from the insurance industry. They did this to minimize any potential compliance cost.

Subsequently, the law contains an explicit exemption for small insurers and their affiliates from data collection requirements. The newly created FIO will have the proper authorization to monitor and evaluate access to affordable insurance products to underserved communities.

This authority promises to help people have access to the proper insurance, which I think is extremely important. I am happy to report that Mr. Mike McRaith, former Illinois State Insurance Commissioner, has recently taken the position of FIO Director, and I would like to wish him well in that position.

On another note, I appreciate that the President moved swiftly to choose a nominee, Ray Woodall to serve as Financial Stability Oversight Council Voting Insurance Expert. The FSOC is charged with identifying the threats to the financial stability of the United States.

It is reassuring to know we will never again find ourselves on the brink of economic collapse. Filling these positions is critical to the implementation of proper oversight and accountability. I hope the newly created FIOS will empower consumer representation. So, I hope to see more of that engagement.

We have a broad range of issues here at the subcommittee, and I look forward to listening to the witnesses. And I thank the gentlelady, the chairwoman for calling the hearing.

Chairwoman BIGGERT. Thank you, Mr. Gutierrez.

I might note that Director McRaith was invited to attend today but was unable to do so, so that we will be meeting with him later.

And I would now recognize another gentleman from Illinois, Mr. Dold, for 3 minutes.

Mr. DOLD. Thank you, Madam Chairwoman. I want to thank you obviously for calling this important hearing, and I want to thank all the witnesses for taking the time to come and testify before us today.

The insurance industry is a large and critical component of our financial services industry and of our economy generally. The insurance industry directly employs over 2 million Americans with stable, well-paying private sector jobs.

Our insurance industry is also the source of billions of dollars of private sector investment capital that is invested each and every year. These investments help other businesses get started, expand, and create even more good, stable, well-paying private sector jobs in all kinds of other industries.

And while providing these direct and indirect jobs and other economic benefits, our insurance industry provides many millions of American policyholders with peace of mind, security, and compensation in difficult, unfortunate, and sometimes tragic circumstances.

But along with all of these positive factors, the insurance industry has some challenges that Congress can and should address.

The first and most urgent challenge is getting Congress to pass a responsible, long-term National Flood Insurance Program reauthorization.

Under Chairwoman Biggert's leadership, the House has overwhelmingly passed that kind of reauthorization legislation on a bipartisan basis, with over 400 votes. We are all looking forward to a prompt Senate passage and to the President signing this important legislation.

But now, we have an equally important obligation to carefully examine how Congress can help modernize the insurance industry's regulatory framework, while identifying and supporting helpful industry-related initiatives.

This raises important and possibly difficult questions about the interaction between Federal and State regulations, the interaction of regulations among the different States, and how our domestic regulations and trade agreements compare to those of foreign nations and are interconnected in the global marketplace.

In the end, our objective here is to create the conditions that will maximize private sector job growth, economic prosperity, and global competitiveness, while also ensuring that consumers are adequately protected and have access to a broad range of affordable insurance products.

I look forward to hearing from our witnesses about how we can achieve these goals and objectives together.

I might not have time to ask all of the questions during my allotted time for questioning, so I might, and probably will, be submitting some in writing.

And so, I want to thank the witnesses in advance for both their testimony here today and for their thoughtfulness in answering my written questions that will most likely be submitted.

And with that, Madam Chairwoman, I yield back.

Chairwoman BIGGERT. Thank you.

The gentleman from Missouri is recognized for 2 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman.

I am not sure I will take 2 minutes. I wanted to use my allotted time to welcome my fellow Missourian, John Huff, to this subcommittee hearing.

He is the director of the Missouri Department of Insurance. He came to that position from many years of working in the industry, and he brought that experience to the State.

We appreciate the work that he has done in Missouri. And he was also named earlier this year as the State representative to FSOC.

I was pleased to see that happen, because in that position, he brings not only the insurance perspective, but the State regulatory perspective to the discussions around the Federal financial system.

So, I would like to welcome Mr. Huff, and I look forward to his testimony.

Thank you for being here.

Chairwoman BIGGERT. Thank you.

The gentleman from Virginia, the vice chair of the subcommittee, Mr. Hurt, is recognized for 1 minute.

Mr. HURT. I thank the gentlelady for yielding, and I appreciate her leadership as this subcommittee engages in the important work of examining the ways in which Federal policies are impacting the insurance industry in Virginia's 5th District and across the country.

The Dodd-Frank Act significantly changed the manner in which the Federal Government interacts with the insurance industry.

Dodd-Frank called for the creation of the Federal Insurance Office to represent the interests of insurers in the context of international regulatory negotiations. The bill also created the Financial Stability Oversight Council and included insurance within the realm of FSOC's oversight.

It is critical that we closely monitor the activities of the FIO and the FSOC to ensure that their activities do not unnecessarily interfere with the insurance industry and the consumers that they serve.

While primary regulation of the insurance market remains focused at the State level, we must be mindful of the cumulative impact of State, Federal, and international regulatory mechanisms with which the industry must comply.

Excessive and unnecessary regulation, I believe, will inhibit the growth of free and open insurance markets, while also limiting consumer choice.

Again, I would like to thank Chairwoman Biggert for holding this important hearing today. I look forward to hearing from the witnesses, and I yield back the balance of my time.

Chairwoman BIGGERT. Thank you.

I would ask unanimous consent to have one of our members of the full committee, Mr. Green, give an opening statement for 2 minutes.

Hearing no objection, you are recognized for 2 minutes.

Mr. GREEN. Thank you, Madam Chairwoman.

I thank the witnesses for appearing, and I thank you for the privilege to sit and be a part of this august body, and I will yield back the balance of my time.

Chairwoman BIGGERT. That was a fast 2 minutes.

We will now turn to our witnesses, and, again, welcome. Let me just say that I will introduce the witnesses, and then you will have 5 minutes to give a summary of your statement. We will then go to questions, where we will have 5 minutes and try and keep to that also.

So on our first panel, first, we have Mr. John Huff, director of the Missouri Department of Insurance, Financial Institutions and Professional Regulations, and he is also on the FSOC Committee. Thank you so much for being here.

Second, Ms. Susan Voss, commissioner, the Iowa Insurance Division, and president of the National Association of Insurance Commissioners. It is very nice to have you here today.

And third, the Honorable Greg Wren, treasurer, the National Conference of Insurance Legislators. Welcome.

We will start with Mr. Huff. You are recognized for 5 minutes.

STATEMENT OF JOHN M. HUFF, DIRECTOR, STATE OF MISSOURI DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

Mr. HUFF. Thank you, good morning, and thank you again for the privilege to testify today.

My name is John Huff, and I am director of the Department of Insurance, Financial Institutions and Professional Registration for the State of Missouri. I serve as a non-voting member of FSOC and I am also a member of the NAIC.

Today, I will discuss our views on systemic risk in the insurance sector, highlight the activities of FSOC that could impact insurance, and then touch upon our international work regarding the development of criteria to identify Global Systemically Important Financial Institutions or G-SIFIs.

As you know, insurance is a unique product. And while bank products involve consumer deposits that are subject to withdrawal on demand at any time, insurance policies involve upfront payment in exchange for a legal promise to pay benefits in the case of a future event.

U.S. insurance companies are also subject to stringent regulatory requirements, designed to ensure that claims are paid in a timely manner.

It is the view of the NAIC that traditional insurance products and activities do not typically create systemic risk.

However, connections with other financial activities and non-insurance affiliates may expose some insurers to the impact of systemic risk, and certain products may provide a conduit for systemic risk.

While much of the Dodd-Frank Act was not aimed at the insurance sector, there are a number of FSOC activities that will have an impact on insurance companies and regulators.

First, FSOC released a study on the Volcker Rule implementation in January. And that study confirmed that the business of insurance should be accommodated by permitting insurers to continue to engage in investment activities.

It also highlighted the importance of consulting with State insurance regulators throughout the rulemaking process.

Second, with respect to the non-bank designation process, members of the Council have previously testified that the Council intends to provide additional guidance and seek public comment.

FSOC continues to work hard on this guidance with the intention of releasing it for comment in the near future. And I encourage all insurance sector participants to weigh in on that guidance.

Third, FSOC released its inaugural annual report on Tuesday of this week. The report underscores that insurance companies generally withstood the financial crisis well, and have strengthened their balance sheets. The report also describes several of the regulatory improvements that the insurance regulators have completed since the crisis.

At the same time, the report identified certain areas that insurance regulators need to continue to monitor closely, including insurer exposures to commercial and residential mortgage-backed securities, municipal bonds, and specific European exposures, as well as the higher-than-usual claims activity resulting from the severe weather in States like my own, when Missouri is recovering from the Joplin tornado, the largest insurance event in our State's history.

Finally, during earlier testimony before Congress, I expressed my concerns about the inadequate representation of insurance interests and specifically insurance regulators on FSOC.

I am pleased that now Mike McRaith, the former Illinois director, has become the first Director of the Federal Insurance Office. Mike is well known among NAIC members, and I consider us very fortunate to have him in this role.

I am also pleased that Roy Woodall has been nominated by President Obama to be FSOC's first voting member with insurance expertise. And I am hopeful that he will be able to join the Council as soon as possible.

I can testify today that FSOC is very close to having its full complement of insurance members on the board as required by the statute.

However, I must report to you that the ability of State insurance regulators to provide input regarding FSOC's important work remains limited.

Such consultation will be vitally important in the coming months, as FSOC determines the criteria to be used to identify systemically important, non-bank firms, and then evaluates these firms for such designations.

The NAIC is a founding member of the International Association of Insurance Supervisors, the IAIS, and is a committed member in all of the major IAIS committees and subcommittees, and serves as vice chair of the IAIS financial stability committee, which is developing criteria for identifying insurers that are G-SIFIs.

There are processes in place that enable committee members to consult with fellow insurance regulators who have unique expertise or insights on specific business models, practices or institutions to help ensure that appropriate methodologies are being considered. This is in marked contrast to my work on FSOC.

The United States is a member of the Financial Stability Board, which is engaging directly with the IAIS on critical issues, including G-SIFI identification. Our direct involvement in this process is critical since the FSB is a bank-centric organization.

Through the IAIS, we continue to stress that insurance needs need to be distinguished from banking. And we have urged the U.S. FSB representatives to reinforce our input and concerns.

Further, the FSB is moving very rapidly in its activities, and I would encourage Federal regulators and legislators alike to be mindful of both the scope and speed of the Board's activity, as this institution should give appropriate deference to the regulatory authorities of its member nations.

In conclusion, throughout the debate over and the implementation of the Dodd-Frank Act, my fellow regulators and I have fought to deliver the message that one size does not fit all.

Both the nature and regulation of insurance products are fundamentally different from the nature and regulation of banking and securities instruments. And we remain hopeful that these differences will be adequately acknowledged and accommodated by FSOC and by our international counterparts.

Thank you for the opportunity to testify today, and I would be pleased to answer your questions.

[The prepared statement of Mr. Huff can be found on page 101 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Ms. Voss, you are recognized for 5 minutes.

STATEMENT OF SUSAN E. VOSS, COMMISSIONER, IOWA INSURANCE DIVISION, AND PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC), ON BEHALF OF NAIC

Ms. VOSS. Thank you.

I am pleased to provide you with a brief overview of recent insurance regulatory activities, including how State insurance regulators are responding to the Dodd-Frank Act, contributing to international standard setting, and improving U.S. insurance supervision.

As you know, the Dodd-Frank Act acknowledges the differences between insurance and other financial products, as well as the strength of the State-based insurance regulatory system.

The State insurance regulators, through the NAIC, have provided input on four main areas of Dodd-Frank implementation: FSOC; orderly resolution; derivatives regulation; and surplus lines and reinsurance. And we are also closely monitoring the implementation of the Volcker Rule, the Federal Reserve's new authorities to oversee SIFIs and thrift holding companies, and the development of the Federal Insurance Office.

I would just like to highlight our efforts on the provisions of the Dodd-Frank Act affecting regulation of non-admitted or surplus lines insurance, which became effective just days ago. Under the law, a surplus lines placement is subject only to the regulatory and taxation requirements of the policyholder's home State.

So to that end, the law authorizes, but does not require, States to enter into an interstate compact or an agreement to allocate surplus lines premium taxes. The NAIC members believe it is imperative to preserve the ability of States to receive premium taxes based on the risks located in a given State.

So, we established a task force to develop a State-based solution that would lead to a Nonadmitted Insurance Multi-State Agreement or NIMA, a proposal for addressing premium tax allocations. NIMA does not transfer supervisory authority to a single compacting entity, but it allows States to share premium taxes in a manner consistent with Dodd-Frank.

NIMA provides a single point of tax filing, utilization of common reporting, schedules, tax allocation formulas, and allocation schedules and a single blended tax rate for each participating State. NIMA responds to many of the concerns raised by surplus lines brokers while seeking to preserve State tax revenues.

Eleven States and Puerto Rico have joined NIMA thus far. And other States have sought alternative solutions including an interstate compact approach. We expect States may ultimately gravitate toward the solution that preserves their maximum level of premium tax revenues.

I will focus the rest of my comments on the NAIC's continued efforts to improve the State-based system of regulation.

As you know, the financial crisis underscored a need for State insurance regulators to enhance and improve group supervision. It is not enough to focus on transactions with an insurance company.

We need to look through the windows and understand the contagions that could impact insurers. Yet, we must retain the walls when examining material exchanges between insurers and other parts of the group.

So, the NAIC adopted revisions to our holding company model act and model regulations to provide regulators the ability to better assess enterprise risk within a holding company's system, and its impact on an insurer within the group. Ultimately, this enhanced windows-and-walls approach should provide greater breadth and scope to solvency supervision.

The financial crisis also revealed that the insurance sector overly relied on credit ratings. The NAIC acted to more closely align the capital requirements for residential and commercial mortgage-backed securities with appropriate economic expectations.

Our new process results in a more accurate reflection of the risk of loss. And perhaps the greatest single source of concern for the insurance regulators during the financial crisis was securities lending activities by AIG.

We have acted to enhance transparency in securities lending agreements through improved guidance and additional annual financial statement disclosures. On the future of insurance regulation, State regulators began the Solvency Modernization Initiative in 2008.

Known as SMI, this project is a critical self-examination of the U.S. insurance solvency system in conjunction with international developments regarding insurance and banking supervision, and the potential use of international accounting standards in the United States.

We believe that SMI will drive changes to our overall regulatory system. We must learn from international developments, but we cannot abdicate our regulatory responsibility. International regulatory forums and standard setting organizations provide critical opportunities for regulators to cooperate, but they should respect the different legal, regulatory, and cultural approaches around the globe.

We are devoting significant resources to our international activity. Solvency II and equivalency recognition in Europe highlights the various systems of regulation. While we support the Europeans' efforts to modernize their solvency regime, we want to help when we can with this worst financial crisis in decades.

We believe that our system is at least equivalent to Solvency II on an outcome basis and have been urging Europe to view equivalents as an outcomes-focused process which will avoid putting U.S. or European insurers at a competitive disadvantage.

Those are just a few of the things that we are focusing on at this time. I thank you for the opportunity to testify, and I look forward to your questions.

[The prepared statement of Commissioner Voss can be found on page 178 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Wren, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE GREG WREN, STATE REPRESENTATIVE, ALABAMA HOUSE OF REPRESENTATIVES, AND TREASURER, THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL), ON BEHALF OF NCOIL

Mr. WREN. Thank you, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. Thank you for inviting me to testify before the subcommittee on behalf of the National Conference of Insurance Legislators, NCOIL, on the very important subject of insurance oversight.

My name is Greg Wren. I am an Alabama State Representative and currently serve as treasurer of NCOIL.

I am pleased to be here today to discuss with you our shared concern; that of the proper oversight of the insurance market and the best interest of all involved.

Like you, NCOIL wants to make sure that the insurance marketplace works effectively and efficiently to promote better products, satisfy consumers, and healthy and thriving businesses.

NCOIL supports and has worked for modernization and uniformity in the State where and when it is needed. We, as State legislators throughout the country with the sole focus of sound insurance public policy, believe that the States have the tools to promote and facilitate that level of modernization going forward.

NCOIL appreciates that the committee has acknowledged the many assets of State regulation, and has not sought to preempt our authority to regulate our unique State markets and to protect our insurance consumers. We are optimistic that the newly created Federal Insurance Office, and other recently formed Federal agencies, will also respect the authority and strength of the State system—strength that was evidenced during the recent financial crisis.

We also believe that proposals such as an optional or mandatory Federal charter would only serve to undercut the successful State system now in place. NCOIL is working and will continue to work with our State regulators, consumer advocates, and industry to strengthen and enhance regulation in key areas that are in need of reform.

NCOIL collaborated with the NAIC and the NCSL to develop a successful Interstate Insurance Product Regulation Compact, IIPRC, a speed to market vehicle for life insurance products now in force in 41 jurisdictions. NCOIL has worked closely with the NAIC to simplify agents and broker licensing and make it easier for a licensed agent or broker to do business in another State.

NCOIL continues to work for better market conduct regulation, and has encouraged our regulator colleagues to modernize exam procedures to free companies from duplicative and costly exams by regulators.

I would like to discuss in more depth NCOIL's most recent modernization effort to streamline surplus lines, insurance taxation, and regulation consistent with your intent under the Dodd-Frank Act.

Today, NCOIL is releasing to you a report entitled, "Implementing the Dodd-Frank Act, State Activity and SLIMPACT and NCOIL Response." Dodd-Frank gave States a very short window of opportunity to comply with NRRA provisions, leaving State legislatures, depending upon our schedule sessions, from as little as 40 days to only 6 months to pass legislation.

Following the enactment of Dodd-Frank, NCOIL, CSG, and NCSL to no avail, called upon Congress to extend the effective date of NRRA surplus lines provisions by at least 1 year to give States additional time to join SLIMPACT.

For the last year, the States have been trying to figure out how to best protect their current surplus line tax revenues at a time when every State budget dollar counts.

Because States have never needed to collect data on home-Stated versus multi-State risk, they have no information to rely upon. As a result, the States have reacted in various ways, such as enacting SLIMPACT, the NCOIL model, passing legislation to tax 100 percent of premium on home-Stated multi-State risks, authorizing insurance regulators and/or governors to enter into compacts and/or agreements, signing an NAIC-backed Nonadmitted Insurance Multi-State Agreement or NIMA, or passing no legislation at all and taking a wait and see attitude.

NCOIL, together with NCSL and CSG, has endorsed SLIMPACT as the only policy solution that fully responds to the NRRA, as it would ease the burden of surplus lines taxation, provide uniformity asked for in the Dodd-Frank, and ensure that the States receive their fair share of premium taxes.

Concerns exist with the other approaches that don't fully address the Dodd-Frank's intent such as NIMA, which has and will continue to face constitutional challenges about its improper and unconstitutional delegation of authority to a regulator who by statute is subject to enforcing laws, not making public policy.

In addition to the legislative group's endorsements of SLIMPACT, it is also supported by the very groups and individuals who asked for the NRRA, including the insurance industry and producer organizations.

Modeled after the successful life compact, the SLIMPACT Commission will serve the compacting States and is authorized to create rules upon those that are agreed by its members.

Though SLIMPACT becomes fully operational when there are 10 States or contracting States, Commission representatives from the 9 current member States are busy at work. SLIMPACT is now honing in on its obligations and we will look forward to progressing further.

We are optimistic that States can, as they have, Madam Chairwoman, for over 150 years, adapt to changes in an increasingly global marketplace and protect their consumers and insurers.

Our achievements with regulation of insurance in the States stand out against the failures of other financial services sectors, and show that the States can do their job. NCOIL believes that targeted insurance reform can work if it is based on coordination, transparency, and disclosure and accountability, and if it embraces the State system.

Thank you for this time, and I look forward to the opportunity for any questions.

[The prepared statement of Representative Wren can be found on page 192 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

For the record, I would just like to say, without objection, all members' opening statements will be made a part of the record. Also, without objection, the written statements of the panelists will be made a part of the record.

With that, we will now turn to our questions. And I will yield myself 5 minutes.

Mr. Huff, and if all the witnesses would care to answer, that is fine—the Dodd-Frank Act has listed 11 factors for FSOC to take into consideration to designate any nonfinancial—nonbank financial company which may include an insurance company as a Systemically Important Financial Institution, SIFI.

In addition, the Dodd-Frank bill says that a bank holding company would have to have at least $50 billion in assets to be designated by FSOC as an SIFI. For nonbank financial companies, the criteria to make the SIFI designation is much less clear.

Do you think that without any other SIFI criteria, the $50 billion threshold is already discouraging insurers with assets just under $50 billion from growing and creating new jobs?

In other words, although to date no companies have been designated as SIFIs, is the SIFI designation already limiting the growth and jobs measure for insurers?

Mr. HUFF. Thank you for the question.

You are correct that under the Dodd-Frank Act, the $50 billion threshold for enhanced prudential standards only applies to the bank holding companies. And FSOC has a great deal of latitude with respect to designating non-banks for heightened prudential supervision.

In my view, size alone is not a good indicator of systemic risk. It is especially problematic from the insurance perspective, since many of the largest non-bank financial companies are insurers with large on-balance-sheet assets, specifically to support their liabilities such as their potential policyholder claims.

And obviously, we don't want insurers to grow to such an extent, or engage in activities that may make them systemically risky. But the analysis regarding insurance companies should be more refined than an analysis of just the size of one's balance sheet.

Designation should be based on a number of indicators of systemic riskiness, in addition to size, including interconnectedness, off balance sheet exposures, leverage, and existing regulatory scrutiny.

I do have concerns that a peer-sized threshold could potentially dissuade insurers from growing in healthy ways. So I share your concern in that regard.

Chairwoman BIGGERT. Thank you.

Would anybody else care to comment?

Then, Ms. Voss—and this is just a very quick question. The NAIC has supported NARAB II during the last two terms of Congress. Does the association continue to support that legislation as introduced this year?

Just a yes or no or a short statement, and then I would ask that you would submit comments for the record.

Ms. VOSS. Absolutely. Thank you, Congresswoman.

Yes, we do support continuing work on the NARAB II. I know we are in conversations with the agent community and the industry.

We think there are some refinements that can be made to make it even better, because we know this is an issue that everybody wants to resolve. So I will get you additional comments—

Chairwoman BIGGERT. That would be great, so that we can use that as we proceed.

Then my third question, is it possible for the NAIC and NCOIL to harmonize the two different models, NIMA and SLIMPACT, to achieve the goal of streamlining the surplus lines regulation and taxation, as outlined in—maybe you can just get together now—

[laughter]

—but as outlined in Title V, how are the States working to achieve the goal? And why doesn't NAIC work with the SLIMPACT model instead of creating another model in NIMA?

Ms. VOSS. I will talk first, and then I will let Representative Wren answer.

I think that we both, obviously, as different organizations decided we would go ahead, our organization groups, that we should get something going.

I think, given some discussions we have had recently between some of our members, who both have passed NIMA and have passed SLIMPACT, there is a lot of discussion about harmonization.

I think you will see, down the road, as States begin to look more fully at this, you will see some more discussions between us. Obviously, each State has their own opinion on which way they want to go. But I think you will see further discussions between the organizations.

Chairwoman BIGGERT. Thank you.

Mr. Wren?

Mr. WREN. Yes, ma'am. I would agree.

And I think one of the key issues that we have been dealing with is the fact that in a very short period of time in 2011, nine State legislatures did, in fact, adopt SLIMPACT within a very, very short timeline that we were given by Congress to be able to move forward on the SLIMPACT model.

And, again, I would suggest that even in the legislation that passed in these 9 States, what is pretty significant to me, Madam Chairwoman, is the fact that in those States, in most of those States, the commission representative is the insurance commissioner of those States.

That was ceded by the State legislatures to these SLIMPACT commissions. So there is a parallel and a consistency of working together, so we did, in fact in those States did cede that responsibility of commission representation.

So, I would agree that there is no cookie-cutter approach, as we look at the surplus lines industry. It is a massive undertaking. We appreciate Congress for stepping up to the plate and giving us the tools that we can now be in this type of dialogue going forward.

Chairwoman BIGGERT. Thank you.

My time has expired, so I recognize Mr. Gutierrez for 5 minutes.

Mr. GUTIERREZ. Thank you.

And, again, thank you to the witnesses for coming.

So, Mr. Huff, regarding Dodd-Frank and the insurance industry, name one good thing and one thing that needs to be improved.

Mr. HUFF. Actually, I think the establishment of the FIO is a good thing. I think it will help us have a single voice internationally. But I think we need to recognize that the State regulators will also continue to have a very active role internationally.

As the functional regulators, and as we get into the weeds on regulation and particularly how we are deemed equivalent, that expertise must be brought to the table, so FIO is a good thing.

I think we still have challenges in making sure that our State regulators are fully involved in the FSOC process. And I am hopeful, with Director McRaith joining and potentially, hopefully, Roy Woodall joining, that we will make progress in that regard.

Mr. GUTIERREZ. And you had a little bit of a disadvantage, Ms. Voss, but the same question?

Ms. VOSS. I do think the FIO, with Director McRaith, is going to be really beneficial and I hope to have discussions with him.

I think the more information that you have as policymakers, the better. And I guess, as one person who has been very involved in the international level as well, we are the functional regulators and actually, the other regulators around the world look to us when we are talking about group supervision of these companies that act globally.

So, I think the more that we can have representation, and our expertise at FSOC, that will be very important.

Mr. GUTIERREZ. Mr. Wren?

Mr. WREN. Yes, sir. I hate to agree with all of them, but I think the FIO, just because of the sheer fact that it was probably 10 or so years ago, as Congress began to wrestle with the likelihood of the possibility of a National Insurance Office under an optional Federal charter that has been around for a while, we saw a very strong migration away from policy perspectives, away from a peer Federal insurance agency in Washington, into an information gathering and an entity, as Director Huff has just said, that allows for the collection of data, allows us to be more involved in the international front.

So, I really do concur on the FIO issue. I do suggest one thing that we would like to see improved on, on behalf of 7,000-plus State legislators, is an active voice by the State legislators in FSOC.

In any other Federal agency that comes down the pike, we are still the legislators who are involved in the determination of statutory responsibilities at the State levels.

And you folks are very keen to that, and understanding. And we hope that, on behalf of NCOIL and our 7,000 State legislators in the future, maybe from the leadership of this committee, our representation might be allowed to participate going forward.

Mr. GUTIERREZ. Let me just—okay, so there is a difference between New York Life, and State Farm, and AllState insurance companies, that most of the American public probably knows about, engages in, and AIG, which I never had an insurance policy with. Maybe I was behind the curve, and I should have.

AIG, I think we would all agree, caused great harm and threat to our economic system.

Mr. Huff, did we take care of it, so we don't get another AIG?

Mr. HUFF. I think that is part of the purpose of FSOC, to bring Federal regulators together with State regulators on insurance, to identify any gaps in regulation.

I think Dodd-Frank did make substantial progress in helping us to identify where we have regulatory gaps, bringing the people together, and to think that we had to have legislation to bring regulators together is a point for discussion.

But we did, and we do, and now folks are talking. So I think that will be the best preventative tool, preventive tool, so we don't have another AIG.

But it is important to remember where the gaps were in AIG, and the strength of AIG was and continue to be its insurance operations. And the riskiness of AIG was in the non-insurance section of that company. And so that is important for us to remember the history of how we got there.

Mr. GUTIERREZ. I guess the point that—part of the problem, when you mix and match, It is not exactly—everyone thinks of insurance as just insurance. They do make other kinds of investments and are involved in other parts of our economy.

So, Ms. Voss, same question.

Ms. VOSS. I think the devil was in the details on this. It is great that we can all sit around the table.

Now what do we do with the knowledge base we have, when we look at these huge systemic organizations, and how we are going to meld our reviews of those?

If we can get there with FSOC, and the legislation, that is a good thing. But we certainly have, I think, a long way to go on determining now where do we go as far as who regulates what, and how do we do it and meld it together.

Mr. GUTIERREZ. How long do you think before that gets resolved, and we can get all back together here again, and talk a little bit about what we have done?

Ms. VOSS. Hopefully, when you get—if Mr. Woodall is confirmed, and you can get a full complementary, I think there will be some robust discussion.

And, maybe within—probably Director Huff knows that better than I—6 months or a year there might be more information.

Mr. GUTIERREZ. Mr. Wren?

Mr. WREN. Yes, sir.

Having spent more than 30 years as an insurance agent with the Northwestern Mutual Life Insurance Company, and understanding the insurance industry, I think quite well, yet serving much like you in an elected capacity; I think we have a tremendous opportunity to see the successes of the insurance industry in America by product line, by company, by region, by State, to see the tremendous solvency situations that present themselves as models, I think, for the other components of the financial services sector.

And as you shared yourself, the differences between a life-only company or a life and a PC company, whatever they might be, the sheer fact is, at the State level, regulators and legislators are on the cutting edge of making sure that solvency is critical and those claims will be paid.

And I think the stalwart aspect of what we will continue to do is to work with Congress to make sure that those bulwarks are always maintained.

Mr. GUTIERREZ. I guess that should probably be our challenges, to make sure that we don't have another AIG, and something that is systemically risky like that. And at the same time, not to put undue—I am going to help you out—not to put undue burdens on an insurance industry that didn't really cause the kind of risk. So I think there is a difference, I want to work. And I would hope that we wouldn't stop the nominations process, so that we can get this work done.

Thank you.

Chairwoman BIGGERT. Thank you, Mr. Gutierrez.

Just two quick comments—first, as a former State legislator, I appreciate your perspective, Mr. Wren. And second, for the record, AIG's holding company was actually a thrift and a federally regulated thrift. And as the witnesses said, there was a separation there.

So with that, I recognize Mr. Hurt, the vice chair, for 5 minutes.

Mr. HURT. I thank the Chair.

I want to first of all thank each of you for appearing before us. And as I am sure you are aware, the Consumer Financial Protection Bureau is something that has been of great interest here in Washington of late.

I would like to confirm probably with each of you—Ms. Warren, as the CFPB is taking shape, has stated that she believes that insurance does not fall within the jurisdiction of the CFPB.

I wanted to get each of you to just speak to that.

Do you agree with that assessment as the law currently is, and do you see any basis in the future?

And we know how Washington operates and how bureaucrats operate. Do you see any basis in the future for expanding that authority within the CFPB absent explicit legislation from the United States Congress?

I will start with Mr. Huff, and then Ms. Voss, and Mr. Wren.

Mr. HUFF. Thank you for the question.

I agree with your conclusion that insurance is not included in the agency's jurisdiction. And I think it is also a testament to the strong consumer affairs departments that we have throughout the State and all 50 States, and the significant work we do to address consumer issues.

It is the area that I spend the most time on in my State, to make sure consumers are treated fairly and that their issues are responded to.

And to be fair to insurers, not all of those queries are complaints. They are really an opportunity for us to have an education process. Many times, they are more inquiries of how a product works, what did I buy? And so that is an area where I think we can do even more on at the State level.

But I am concerned in all aspects of Dodd-Frank for us to be vigilant on mission creep. Because I think we need to be careful that because insurance is excluded from that agency, that there are no back door attempts that may have potential to cause confusion for consumers.

Mr. HURT. Thank you.

Ms. VOSS. I would say that one of the positives that has come out of the whole Dodd-Frank debate was reaching out to Federal regulators to share information. And I have to say, we have struck a very good conversation with Chairman Schapiro from the SEC about consumer issues.

And whenever we are in Washington, we always reach out to her and her staff. And we actually have regular dialogues. The Federal Reserve comes to our meetings.

So I think as far as consumer protection, I would agree that this new body does not have authority over insurance. But we are reaching out to talk to Federal regulators on a regular basis about consumer issues.

Because we know that people who are buying insurance products may be interested in securities products and other financial instruments. And for us to at least have regular dialogue with them is very helpful in the interchange of information.

Mr. HURT. Madam Chairwoman, do you see any basis for future expansion of the CFPB's footprint into insurance absent legislation by the United States Congress?

Ms. VOSS. I don't think so. I hope not.

Mr. HURT. Thank you.

Mr. WREN. Congressman, I would like to say that NCOIL, in collaboration with this committee and the Congress, has strongly encouraged the insurance component to be left out.

And I think one of the reasons why we made that strong case over the last couple of years is simply because it allowed us to present the case about how effective the States are in resolving consumer complaints and consumer issues through our regulatory agencies across the country.

The business of insurance being left out, I hope, portends that in the future it will remain to be left out. I think as long as we continue to do our job, we will benefit from it.

We also have a strong system that we work with as State legislators, as regulators, the North American Association of Securities Administrators, NASAA, the National Association of Attorneys General. We have a strong State-based group throughout the canopy of our efforts in the consumer areas to benefit everybody from Alaska to Wyoming.

So the future, I hope, is much as it is today. As long as we continue to do our job, work in concert with Congress, we look forward to being able to make sure that those lines of insurance stay out of it. And we will work collaboratively with the Congress going forward.

Mr. HURT. Thank you. I yield back.

Chairwoman BIGGERT. Thank you, Mr. Hurt.

The gentleman from Missouri is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Let me direct my first question to you, Mr. Huff.

You bring some uniqueness, I think, to the FSOC. And so I am wondering whether your fellow FSOC members are listening to the State perspective that you might bring, and to the insurance perspective. Are you finding fertile ground as these extremely important financial issues are surfacing?

Mr. HUFF. Thank you for the question. And the FSOC process—it has certainly been my privilege to serve with the regulators on FSOC. And folks have been very respectful of me and of my views, particularly bringing an insurance perspective.

I think we did miss some opportunities during this first year of not having the full complement of insurance expertise on FSOC. But as we have all stated here, we have made great progress in that regard.

And now with all three of those spots being filled, hopefully very quickly, I just think we need more dialogue on those insurance issues. And hopefully, that will move us forward in making sure that insurance is properly recognized.

Mr. CLEAVER. Thank you.

This is for any of you. The question is, are small insurers sufficiently protected from potential burdens of having to comply with the data request from the FIO?

Mr. HUFF. There are some parameters within Dodd-Frank that do protect small insurers. But just the broader issue of data collection, Congressman, I think is one that is worth speaking to, because our National Association of Insurance Commissioners is really a data powerhouse in terms of insurance regulatory information.

And it is so important that we don't—through the efforts of the OFR or the FIO or FSOC, through any of those efforts, it is so important that we don't duplicate what we already have in place. And we have already made those investments for that data collection.

And as you know, much of that data sits in your district. So it is important that we think through methodically how we can share that data on a meaningful basis with all regulators.

Mr. CLEAVER. Mr. Wren, do you concur?

Mr. WREN. Yes, sir.

Mr. CLEAVER. I yield back the balance of my time.

Chairwoman BIGGERT. Thank you.

The gentleman from Illinois is recognized for 5 minutes.

Mr. DOLD. Thank you, Madam Chairwoman.

Ms. Voss, I understand that as currently written, the NAIC's Nonadmitted Insurance Multi-State Agreement or the NIMA tax allocation methodology, which seems to involve a novel allocation of casualty lines, is burdensome on brokers and will add cost to consumers.

Does the NAIC, or do the NIMA States have the ability to refine the allocation methodologies, especially since the tax clearinghouse isn't operational yet?

And can you tell us when the NIMA clearinghouse might be fully operational?

Ms. VOSS. We have 11 States and Puerto Rico that have passed NIMA. And they are in discussions right now on a clearinghouse.

Obviously, this is just at the beginning stages. We would probably take issue if people believe that it is going to increase taxes. And I know there have been a number of different legal opinions.

Having said that, I have to say that 11 States have probably had their legal counsels look at it, and felt comfortable in passing the legislation. Right now, there is discussion between the NIMA States and Puerto Rico about vetting a process to have someone set up the clearinghouse similar to IFTA, the fuel tax association.

So, that is what we are looking at right now and haven't made any clear decisions about. But we are certainly in discussions right now. They have just added a couple of other States, so I think it will be coming on very soon.

Mr. DOLD. Okay. The NAIC has taken the position that it is not a State governmental entity, while at the same time it has testified to Congress that it should be recognized as a regulatory agency in Federal law.

Absent an insurance regulator with national authority, has the NAIC become a de facto national insurance regulator?

If so, is this role and function appropriate with the NEIC's stated mission authority and advocacy practices?

Ms. VOSS. The NAIC is really our organization that helps us put standards together, standard setting, and sort of collectively represents what our thoughts are. We don't put ourselves out as some regulatory body.

Having said that, I think through even Federal regulation laws, if you look at the Health Care Reform Act, the NAIC has been asked to set standards for certain processes under PPACA. And so collectively, the regulators get together and discuss those.

But we don't hold ourselves out as some kind of Federal or national regulatory system. We are a national body that represents all of the regulators.

Mr. DOLD. The existing insurance regulatory structure is a barrier to product portability, in my opinion. When consumers move to a new State, producers must register, take tests, do background checks, and pay fees to continue serving the customers with which they have established relationships.

I am sure you have encountered this with a number of people that you work with.

Similarly, products are not uniformly offered from State to State so that a product that meets a California consumer's needs might not be available to that same customer if he or she moves to my State of Illinois.

How do you recommend that we encourage greater uniformity, meaningful licensing reform, and an efficient product approval under the existing State-based structure?

Ms. VOSS. I will address it in a couple of different ways. First of all, we have the interstate compact on policy on life products and annuities and some long-term care—42 States have joined the compact. So it is a once and done for those 42 States.

We would encourage the other States, such as New York and California and Florida—having said that though, there are States that have barriers to joining compacts because of their constitution.

We all—as Representative Wren, he is a policymaker in his own State. And they may choose to comply or not or enter into an agreement.

We totally agree that there needs to be greater uniformity and producer licensing. And we have been working very hard on that as we try to work through NARAB II.

And obviously once again, some States have different opinions on how they want to protect their consumers, what products they want to be allowed in their States. That is always going to be a challenge for us as State regulators. And so we look for things like compacts or agreements to help us further those set uniformity charts.

So, I understand your concerns. We will try to work through those as best we can on a State by State basis.

Mr. DOLD. Thank you. Mr. Huff, the ability to bring new innovative insurance products to market continues to be one of the greatest challenges with the existing regulatory system. What regulatory changes can be made to bring new products to the market across the country more quickly?

Mr. HUFF. I guess I would add on the asset-based products, I would build on what Commissioner Voss just talked about, about the interstate insurance compact that we have on life and asset products—which actually Illinois has just joined that compact, one of our most recent members—that it is a great vehicle for speed to market as we term it, to get products through a vetting process to make sure consumers are protected, and that they are actuarially sound.

And so, I would say that is a very strong vehicle for new product development.

Mr. DOLD. Thank you so much.

Madam Chairwoman, my time has expired.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from Ohio is recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman. And I appreciate the panel and appreciate your testimony.

My first question is for Mr. Huff. I believe that the property casualty insurance industry is not systemically risky. And I wanted to get your opinion on whether you foresee any property casualty insurance companies being designated as systemically important financial institutions?

And if so, do you think that would be appropriate?

And then, I would like you to address the mutual model too. Do you think that the mutual model of property casualty companies is systemically risky?

Mr. HUFF. In my initial comments, I did give the NAIC view, and it is my view as well, that traditional operations and traditional—particularly on the P and C side, those operations would not, in my estimation, be systemically risky.

And I guess the caveat to that of course is the interconnectedness or any non-insurance activities that are going on. So, I think the clearest story to tell is on the P and C side, that I think it would certainly be a stretch to see how any of those activities would be systemically risky.

Mr. STIVERS. Great. Thank you so much.

My next question is for Ms. Voss. You said earlier that 11 States had joined the Nonadmitted Insurance Multi-State Agreement. Have any States passed the surplus lines—insurance, multi-State compact? I don't think any have.

Ms. VOSS. Nine States have passed it, yes.

Mr. STIVERS. Oh, nine have? Okay.

Ms. VOSS. And it becomes operational at 10 States.

Mr. STIVERS. Okay.

Ms. VOSS. And I would just add to that—and of course Representative Wren can talk as well—there are a lot of States that are trying to blend those two, or they have legislation that—

Mr. STIVERS. That is really the next part of my question—

Ms. VOSS. I am sorry.

Mr. STIVERS. —is there a way to blend those two models?

And can they easily be put together? Or are there things in the two—because I have not studied either one of them in detail—that would make it hard to blend the two?

Ms. VOSS. I think there are. And I will let Representative Wren speak—

Mr. STIVERS. I guess I should ask Representative Wren about that—

Ms. VOSS. I think that there are ways to meld the tax allocation.

One of the challenges for some States is they have a constitutional amendment that doesn't allow them to enter into certain compacts that cede certain authority to a compact. So, that is a challenge.

But given that, I think there are some ways we can look at the tax—

Mr. STIVERS. Great. I will direct to Representative Wren, and as a former—

Mr. WREN. Yes, sir.

Mr. STIVERS. —co-chair of NCOIL, I appreciate what you do and we wrangled with those—I was the author of the interstate compact—

Mr. WREN. Yes, you were—

Mr. STIVERS. —in Ohio. And we wrangled with a lot of those issues that make it difficult. But we got around them. And I know a lot of States can ultimately get there.

But are you finding it hard to put those two proposals together?

Mr. WREN. Congressman, first of all, thank you, and I appreciate you being here as an NCOIL colleague. I look forward to you inaugurating the NCOIL caucus here in the U.S. House.

But I think as President Voss has said, as we try to deal with the dynamics of the organizations, whether it is the NAIC, or NCOIL, and the NCSL, the State legislative groups, it is obvious that we have to respect a tremendous amount of local autonomy.

You have been there. And you understand, most of you, and the chairwoman has already said that. I think one of the elephants in the room would be the allocation formula issue.

SLIMPACT is very close to working out internally with our situation the allocation formula that I think will be using the readily available data, and simplicity, and uniformity. And I think that will be a hallmark of what we are doing.

I think we are going to have to have some strong dialogue going forward as to whether or not we can look at blending or melding in some way the NIMA models, the SLIMPACT model, or for those States that right now are taking the wait-and-see approach, which very well could cost State budgets when every dollar of the State budgets are very critical.

So the important aspect of this particular hearing is that we are here in this panel, and we appreciate the time. And we will talk in the hallways and hug each other.

Mr. STIVERS. Great. One last question for Representative Wren, because I have about 50 seconds left.

Do you foresee any changes that are necessary in the Dodd-Frank Act as you figure all this stuff out at the State level?

Mr. WREN. Yes, sir. I think probably again—and I think the most important aspect is that we would beg Congress to allow your State legislators through our organizations as you would deem fit working with us, to have a voice—to be not just in Washington, or in a room, but to be at the table when you begin to make more significant determinations about the insurance aspects of financial services.

We do beg your indulgence and your participation in including us going forward, as we look at these critical issues with you.

Mr. STIVERS. Thank you so much. And I do want to just make a plug for the fact that these interstate compacts work.

Obviously, there are some States that don't join, but they work pretty well.

Mr. WREN. Yes, sir.

Mr. STIVERS. Thank you, Madam Chairwoman. I yield back.

Chairwoman BIGGERT. Thank you.

The gentleman from New Jersey is recognized for 5 minutes.

Mr. GARRETT. I thank you very much. And I thank the Chair for holding this hearing today.

I just have a couple of questions for the panel, but before I do that, may I enter into the record from the ACLI their letter of Dirk Kempthorne and—president of—I don't see a date on it, but may I enter it in the record?

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. GARRETT. Thanks very much.

For Ms. Voss, greetings, good morning—so as you probably know, with regard to the Dodd-Frank bill, although we were not much in support of that, I was I guess you could say the lead Republican sponsor in the bill with regard to the surplus lines reform section.

And so I wonder if you could just comment on whether you think that the provisions that were set forth in that bill are being carried out with regard to the NAIC's implementation of the law?

And whether or not it frustrates, whether it complies with it, goes along with it? Or whether it frustrates it with respect to the aspects of the burdens that it places on brokers with respect to the cost that it places on consumers?

So if you can explain how the NAICs Nonadmitted Insurance Multi-State Agreements, and specifically the tax allocation methodology, whether or not they adhere in your opinion to the letter and the spirit of the law that we were trying to champion in that legislation?

Ms. VOSS. I think the model that was passed by the NAIC membership does meet the mandates.

I know there is a lot of discussion that somehow this represents a tax increase. But at least our general council has opined that joining NIMA does not increase policyholders' taxes.

It is we are utilizing a clearinghouse and the taxing authority of the insured's home State on a multi-State placement, to preserve the present aspects of the present system, whereby States receive a portion of the premium tax based on the amount of the risk located in the State.

And under NIMA, any State-specific assessments must be included in the State's blended rate, and would apply to the portion of the risk located in the State.

Specifically, NIMA mandates the use of a single blended tax rate for participating States, a provision that was added pursuant to industry suggestions. And in addition, NIMA establishes uniform requirements for premium tax allocation reporting.

And while there may be some disagreement among regulators and industry about some of the details of the allocation formulas, regulators have expressed their willingness to continue to engage in a dialogue.

And I think in my previous comments, we have talked with some of our members who are members of SLIMPACT, and members whose States passed NIMA who are trying to find a way on this tax allocation, so that we can reconcile this.

Obviously, the Dodd-Frank bill was not as prescriptive as to say, this is the way you must do it. So, it is left to the States and the regulators to determine that. And there are two different versions and we are trying to see how we can come to some kind of agreement.

Mr. GARRETT. I appreciate that. So at this point in time from your testimony you just gave—you would say that there is not, in your perspective, an additional burden on the consumer.

Ms. VOSS. That is what we believe.

Mr. GARRETT. Okay. And with regard to the brokers—you mentioned with regard—

Ms. VOSS. We don't believe so.

Mr. GARRETT. Okay.

Ms. VOSS. But we are always happy to talk to anyone—

Mr. GARRETT. Engage—

Ms. VOSS. —chat.

Mr. GARRETT. I appreciate that.

Mr. Wren?

Surplus line laws acknowledge that you can enter into what—multi-State agreements or compacts. Actually, I guess the terminology is—you can do that under constitution—

Mr. WREN. Yes, sir.

Mr. GARRETT. —as well. But under this you now—you can do that? And if you do that—into a multi-State agreement, you can allocate the premiums pursuant to the terms of the statement.

In your opinion, participation in a compact or agreement is not required by the NRRA. But in your experience, have States accurately understood the NRRA's objectives and that tax sharing is not required?

Mr. WREN. I believe so. I think—yet we have fought with this very short time window that we had across the States to be able to engage as State legislative sessions began to start in January of 2011. So, I think more information is out there, which is why we at NCOIL had asked Congress last year for an extension of the time to be able to put our case back out there.

We would still hope that might be something that could be considered. But we are moving forward as expeditiously as we can.

I think that the fact that the strength we have of NCOIL, and NCSL, and council State governments, industry producers, regulators that we have worked with, stamping offices across the country—we feel like we have a very strong hold about the issues that are present here, particularly as we work through this tax allocation issue.

Ms. VOSS. May I add just one thing?

Mr. GARRETT. Please.

Ms. VOSS. I think in fairness to the States—and Iowa passed nothing. And we had both bills before the legislature.

But on top of that, we were dealing with health care reform, new governors, new legislators. And I think, in a very short period of time, there was a lot on legislators plates, and I think if we had a little more time, we might have had a better system of getting this issue resolved.

But time was kind of a concern for many of us.

Mr. GARRETT. That is a concern on a number of fronts that we are hearing in this panel and committee. But I appreciate your adding to that, of course.

Mr. WREN. Thank you.

Mr. GARRETT. Thank you. I yield back.

Chairwoman BIGGERT. Thank you.

Just to follow up, do you think that we need still to extend the time?

Mr. WREN. On behalf of NCOIL, absolutely. I think that is where the synergy is going to be more evidence itself as we can go forward on this is to allow us that time.

We have done a yeoman's work, we think, in 9 States in about 100 days or 110 days. To move it through 9 legislatures in 110 days in 2011, we think, is particularly striking. We would look to support you in that effort, if there is anything that could be moving that could do such.

Ms. VOSS. Madam Chairwoman, the good thing would be that we are sort of coming down to two or three different options, then we can all look at those and see what is the best one.

But, obviously, some of us will need a little more time.

Thank you.

Chairwoman BIGGERT. Thank you all.

The Chair notes that members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

And I would like to thank this panel so much. You have been great witnesses and very, very helpful.

So with that, you are excused, and we will go to the second panel.

As the second panel moves forward, I would just like to, without objection, ask unanimous consent for the following to be included as part of today's hearing record: a statement dated July 28, 2011, from the National Association of Insurance and Financial Advisors; a statement dated July 28, 2011, from the Independent Insurance Agents and Brokers of America; a statement dated July 28, 2011, from the National Association of Mutual Insurance Companies; a statement dated July 28, 2011, from the Council of Insurance Agents and Brokers with an addendum; a letter dated February 10th from Chairman Baucus and Ranking Member Frank, Ranking Member Gutierrez and Chairman Biggert; a letter dated March 9th from Treasury Secretary Geithner; and a letter dated May 20th from me, Chairman Biggert, to Appropriations Subcommittee Chairman Emerson.

I would like to welcome the second panel. And just for the record, without objection, your written statements will be made a part of the record.

Our second panel, going down the line, consists of: Mr. Gary Hughes, executive vice president and general counsel, American Council of Life Insurers; Ms. Letha Heaton, vice president, marketing, Admiral Insurance Company, on behalf of the National Association of Professional Surplus Lines Offices, Ltd.; Mr. Birny Birnbaum, executive director, Center for Economic Justice; Ms. Leigh Ann Pusey, president and CEO, American Insurance Association, on behalf on the Financial Services Roundtable and the American Insurance Association; Mr. Andrew Furgatch, chairman and CEO, Magna Carta Companies, on behalf of the Property Casualty Insurers Association of America and the National Association of Mutual Insurance Companies; Mr. Clay Jackson, CPCU, senior vice president and regional agency manager, BB&T Cooper Love, Jackson, Thornton & Harwell, on behalf of the Independent Insurance Agents and Brokers of America and the Council of Insurance Agents and Brokers; and Mr. Eric Smith, president and CEO, Americas, Swiss Re, on behalf of the Reinsurance Association of America.

Thank you all for being here.

We will start with Mr. Hughes. You are recognized for 5 minutes.

STATEMENT OF GARY E. HUGHES, EXECUTIVE VICE PRESIDENT & GENERAL COUNSEL, AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

Mr. HUGHES. Chairwoman Biggert, and members of the subcommittee, the ACLI appreciates the opportunity to discuss with you issues that are important to the life insurance business.

The insurance regulatory framework is undergoing some of the most profound change in its history, so your hearing is quite timely. We believe it is very important for the subcommittee, and other committees in Congress with jurisdiction over insurance, to have a sound understanding of how our industry operates and an appreciation of how your decisions and those of regulators affect our competitiveness at home and abroad.

The number of domestic and foreign agencies, offices, departments, and organizations currently involved in the regulation of, or standard setting for, the insurance business is large and growing. Effectively coordinating U.S. policy and input for all of these groups is indeed a challenge.

With that in mind, I would like to focus my remarks this morning on why the ACLI believes that the new Federal Insurance Office, FIO, is an extremely important new player in the insurance arena and why it is important for that office to be fully funded and staffed as quickly as possible.

As others have said on the panel this morning, we have a strong State-based system of insurance regulation in the United States. And our State regulators have coordinated with us on the development of international standards, and engaged with us in those foreign markets where resolution of commercial and regulatory issues benefit from their expertise and involvement.

We have also received strong support on trade issues from USTR and the Commerce Department.

That said, we believe there is a continuing gap in the representation of U.S. national interests in international insurance and financial services forums. And we believe the FIO can and should be instrumental in filling that gap.

I would like to highlight for you this morning two key matters in which we believe the immediate engagement of the FIO is essential.

The first is the effort by the IAIS to develop criteria and a methodology for the designation of G-SIFIs. As the G-SIFI initiative has progressed, we have asked State insurance regulators to provide us with their views on the details of that project.

We have also asked for their support in addressing concerns that the initiative conflicts with State insurance laws protecting the confidentiality of sensitive, non-public company information.

Unfortunately, our regulators have told us that they have a limited ability to discuss specifics due to admonitions by the IAIS that this is a closed regulatory only process.

We also understand that a number of non-U.S. regulators have informally asserted that there are no G-SIFIs in their home country. Such a stance would protect their domestic insurers from heightened regulation, but it would potentially result in the creation of commercial winners and losers.

We believe this is contrary to the intent of the G-20 member countries and inconsistent with U.S. policy.

Again, we have expressed our concerns to the NAIC and State regulators, but again we have been advised that they are not in a position to give us substantial help.

The FIO could act as a strong Federal advocate and demand that the focus of the G-SIFI exercise be a balanced outcome that doesn't harm the competitiveness of U.S. insurance and reinsurance companies.

The second area where we believe FIO needs to engage is working with State regulators and European policymakers to ensure that the United States is eligible for a deemed equivalency determination under Solvency II. If the United States is not deemed equivalent, U.S. insurers would be placed at a serious global competitive disadvantage, and non-equivalency would also carry with it the potential for increasing costs and, correspondingly, rates for U.S. insurance consumers.

State insurance regulators have represented the United States in the equivalency discussions to date, but with the passage of Dodd-Frank and the creation of the FIO, there is a strong expectation by European policymakers that our Federal Government, through the office of the FIO, should be an active participant in the equivalency deliberations.

On the domestic front, job one for us is and has been implementation of those aspects of Dodd-Frank relevant to life insurance companies. The attendant policy issues are largely resolved, but the outcome of various rulemaking activities will certainly shape our ultimate view of this new law.

Among the issues that are most important to us are the use of derivatives to hedge portfolio risks, the Volcker Rule, holding company regulation by the Federal Reserve, harmonized standard of care for broker dealers and investment advisors, and FSOC's process for identifying systemically important financial institutions, and the regulatory consequences of such a designation.

Our principal concern with each of these issues echoes a theme that you heard from the previous panel, which is that a fair balance be struck between regulatory interests on the one hand and legitimate business practices on the other. And our concern is heightened by the fact that there has been a tendency throughout the legislative and rulemaking process to view these issues largely through the bank lens.

Life insurers are distinct from banks in terms of their fundamental business model, their financial structure, and their regulatory oversight. And a one-size-fits-all approach to rulemaking will not produce workable results.

We believe the FIO can work constructively with the insurance industry and our regulators to more effectively address these issues.

We also think the FIO has a role in the area of reinsurance. We have urged State regulators to coordinate with the FIO on determinations regarding the quality of reinsurer supervision in other countries.

These determinations will be key to implementing reinsurance collateral reform in the United States. And collateral reform is critical to the European Commission as it considers equivalency under Solvency II.

In sum, Dodd-Frank empowers the FIO to set U.S. international insurance policy and serve as a focal point within the Federal Government for information and expertise on the insurance business.

Failure to provide the office with the resources necessary to carry out these functions risks harming U.S. competitiveness, both domestically and globally, and again for this reason, we urge that the FIO be fully funded and staffed as expeditiously as possible.

Chairwoman Biggert, again, thank you for holding this hearing. And I would be glad to answer any of your questions, or those of the subcommittee.

[The prepared statement of Mr. Hughes can be found on page 108 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. Heaton, you are recognized for 5 minutes.

STATEMENT OF LETHA HEATON, VICE PRESIDENT, MARKETING, ADMIRAL INSURANCE COMPANY, ON BEHALF OF THE NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS LINES OFFICES, LTD.

Ms. HEATON. Good morning. Thank you for taking the time to listen to our testimony today.

Chairwoman Biggert, and members of the subcommittee, my name is Letha Heaton, and I am here today in my capacity as president of the National Association of Professional Surplus Lines Offices, NAPSLO.

I am pleased to offer testimony regarding the impact of the surplus lines insurance reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act, specifically, Title V, Part 1 of the Act, otherwise known as the Nonadmitted and Reinsurance Reform Act, NRRA.

After reviewing the written testimony of the NAIC yesterday, I will deviate from my previously prepared remarks to focus on some very serious concerns that NAPSLO and our membership and others in the industry have about the proposed NIMA approach to a State compact.

The surplus lines reforms in Dodd-Frank were broadly supported and much needed, and intended to significantly simplify the nonadmitted insurance market.

But as I will explain, certain State interpretations and implementation of that law has, in our members' view, been inconsistent with Congress' intent, and threatens to undermine the good work of the committee and Congress in passing the law.

I want to thank my colleagues in this hearing for also noting in their testimony their concerns with certain aspects of that State NRRA implementation currently being proposed by NAIC.

In my remarks, I will briefly review why these surplus lines reforms were needed and comment on the State status of implementation, explain why NAPSLO has serious concerns about the NAIC's proposed tax sharing scheme, called NIMA, and suggests a way to fix NIMA's tax sharing methodology, should some States and the NAIC continue to pursue the NIMA approach.

Very briefly, by way of background, NAPSLO is the national trade association representing the surplus lines industry and the wholesale insurance marketing system.

Surplus lines insurance is property and casualty insurance that covers unique, unusual, or non-standard risks that are not typically offered by insurers operating in the admitted marketplace.

The surplus lines market facilitates the economy by providing insurance cover for new businesses and innovative products, like green technologies and clinical trials for new medical therapies.

Surplus lines insurers also provide a public interest backstop when crises like 9/11 or Hurricane Katrina restrict the capacity of the standard market. For this reason, we are known as safety net insurance.

For years, the surplus lines insurance community regulators and industry alike required the need to streamline the regulation of surplus lines industry and modernize surplus lines tax reporting and allocation procedures.

As envisioned by Congress and supported by all stakeholders, the NRRA would both streamline tax payment processes, and make more uniform, simple, and efficient other aspects of the surplus lines regulation to enable brokers who are the providers to more easily and efficiently comply with State requirements.

Immediately after the passage of the Dodd-Frank Act, NAPSLO offered to help the NAIC, State policymakers, regulators, insurance brokers, and companies with NRRA implementation and with ongoing compliance, including drafting implementation legislation for each State and meeting with legislators and insurance commissioners.

To date, 43 States have passed some sort of NRRA implementing legislation. And a number of these States as well as the NAIC have offered guidance and/or bulletins to brokers regarding the new home State rules for multi-State risks and other aspects of NRRA compliance.

NAPSLO is alarmed if the NRRA is being implemented in many feed States as promoted by NAIC in such a way that will make things more complicated, worse, not better, for surplus lines stakeholders. I will explain and offer a suggestion for improvement.

As you have heard, there are two competing approaches for sharing multi-State surplus lines taxes: SLIMPACT, which is supported by NCOIL, and many industry stakeholders; and NIMA, which is proposed by NAIC.

While there remain numerous uncertainties over the NAIC's NIMA system over how the NAIC's NIMA system would work, NAPSLO believes that the underlying proposal doesn't fulfill the intent of Congress to establish an efficient and more uniform regulatory process.

NIMA focuses solely on creating a tax sharing system, while neglecting the law's other goal to make more uniform, simple and efficient other aspects of surplus lines regulation.

Again, our industry is not interested in avoiding the regulation or the taxation. We just want a simple, efficient system that allows us to comply.

The NRRA went into effect a week ago, and a dozen States have adopted NIMA.

The NIMA system is far from operational, however. We have heard that the NAIC itself has proposed to run NIMA, so that for a fee and for profit, the NAIC would collect and allocate multi-State taxes.

NAPSLO and other industry stakeholders have consistently opposed the NIMA tax-sharing system, because as currently drafted, it fails to create the non-tax regulatory efficiencies or uniformities envisioned by Congress, instead choosing only to address tax allocation issues.

It violates the NRRA requirements that no State, other than the home State, may require any premium tax payments for non-admitted insurance and it involves unnecessary and burdensome data reporting by brokers for the sole purpose of collecting taxes, including novel allocations, requirements for the casualty lines.

NAPSLO strongly opposes NIMA's current tax allocation methodology as it is based—we see it as wholly unworkable for the vast majority of the industry. And if implemented, it will result in new costs and fees levied on surplus lines consumers.

Let me be clear, NAPSLO patently disagrees with the testimony that NIMA is consistent with Congress' intent for the surplus lines reforms.

A single tax payment to the contemplated NIMA clearinghouse is not worth the burden placed on brokers in the form of increased data reporting, the unworkable tax allocation methodology, and the systemic complexity inherent in the NIMA system.

To be consistent with Dodd-Frank—

Chairwoman BIGGERT. Ms. Heaton, if you could conclude please—

Ms. HEATON. Okay.

To be consistent with Dodd-Frank, we understand that the frustrations you hear from us—we would like to understand that the frustration that you hear from us is not directed at this committee.

We commend you for passing the NRRA. Rather, NAPSLO members are frustrated and disheartened by the States' insistence, through NIMA elections, for the allocation methodology and want to address the regulatory concerns required by the NRRA in a different fashion.

Thank you.

[The prepared statement of Ms. Heaton can be found on page 70 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Birnbaum, you are recognized for 5 minutes.

STATEMENT OF BIRNY BIRNBAUM, EXECUTIVE DIRECTOR, THE CENTER FOR ECONOMIC JUSTICE

Mr. BIRNBAUM. Thank you, Chairwoman Biggert, for inviting me to testify, and thanks to the other members of the subcommittee.

I am the executive director of the Center for Economic Justice, which is a nonprofit organization that advocates on behalf of consumers on insurance, credit, and utility issues.

I would like to preface my testimony by saying that sound regulation is consistent with, and necessary for, job creation. We have seen the effects of ineffective and lax regulation with the financial crisis.

With ineffective regulation, companies bring poor products to market. Those products explode.

Those jobs that were created are lost, and then there is more job loss as the consumers whose wealth is lost, because of those defective products, now reduce their demand. Overall consumer demand is reduced, and we see the effect of that. We go into a recession.

So, strong and efficient regulation is consistent with sustainable job creation and it is necessary for the creation of fair competition.

The Dodd-Frank Act did have fairly limited activity in the realm of insurance. But the activities that are included, I think, are very useful.

The Federal Insurance Office was created to create an expert on insurance at the Federal level.

This is obviously useful, given the great number of Federal insurance programs: flood insurance; terrorism insurance; crop insurance; and a whole host of things the Federal Government is involved with.

It surely makes sense to have an expert at the Federal level.

The Federal Insurance Office is involved in international issues. Again, this makes a lot of sense.

Currently, we have individual States forming agreements with the regulators from foreign countries.

We have the NAIC entering into agreements with regulators from foreign countries. The NAIC is a trade association. Clearly, there is a need for some sort of Federal presence to argue for the national interest in the realm of insurance.

The third thing that the Federal Insurance Office does, through the Dodd-Frank Act, is it is given authority to look at the availability and the affordability of insurance.

This is a direct response to the State regulators' failure over decades to address issues of insurance redlining. The FIO has the ability to collect data, to analyze redlining, and unfortunately, that is needed.

State regulators have failed to collect any meaningful data to look at issues of availability and affordability. For example, in the past recession there was an issue of whether insurance credit scoring was harming consumers because of the recession.

State regulators had no data on that. They were incapable of doing that.

In contrast, if you look at what is available for lending products through the Home Mortgage Disclosure Act, regulatory agencies and fair lending organizations were able to do quite a bit of analysis on the nature of the problems in the lending market and where those problems were coming from.

So, this set of authorities for the Federal Insurance Office is really important. And I think it is a direct challenge to State regulation.

The State regulators could step up to the table. But if they don't, it seems to me that the FIO is in a position to fill that gap.

The last point I would like to make is that the FIO is responsible for identifying regulatory gaps. Again, this is very important.

If you look at the regulation of insurance, it is truly a hodgepodge. You have not only a number of States competing with each other for the most favorable regulatory climate, but you have admitted carriers, and non-admitted carriers. You have an interstate compact. You have risk retention groups.

There are all sorts of opportunities not only for regulatory arbitrage, but for gaps between products that may be insurance or they may be financial products. We see those issues come to a head on things like annuities and other sorts of financial products that life insurers and banks sell.

So it is really useful for the FIO to be able to identify these regulatory gaps.

One of them that I want to bring to your attention is a gap related to credit-related insurance products. Right now there is a product called lender-placed insurance.

If a consumer takes out a mortgage and fails to maintain insurance, the lender is able to purchase insurance—not purchase, but place the insurance and then charge the consumer for it. It is very, very expensive.

And the lender has an incentive to do it because the lenders actually get a commission for this lender-placed product. The amount of lender-placed insurance grew from $1.5 billion in 2004 to $5.5 billion last year. Despite being told about these problems, insurance regulators have failed to take any action.

The payout on these products in the last 2 years has been about 17 to 18 cents on the dollar. This is the kind of thing that really burdens consumers who are already having a difficult time paying for their mortgage because of the economic recession.

Now, this is the type of thing that says, this is done by lenders. Should it be regulated by the agencies that deal with lenders, or should it be regulated by insurance regulators? That is why there is really sort of a regulatory gap there.

One of the things that you may consider—and I will finish up with this—is the idea that the Consumer Financial Protection Bureau, which currently does not have the authority, should be given the authority to work on credit-related insurance products. That way, the Financial Protection Bureau could address these problems in the event that State regulators don't.

Thank you.

[The prepared statement of Mr. Birnbaum can be found on page 52 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. Pusey, you are recognized for 5 minutes.

STATEMENT OF LEIGH ANN PUSEY, PRESIDENT & CEO, AMERICAN INSURANCE ASSOCIATION, ON BEHALF OF THE FINANCIAL SERVICES ROUNDTABLE (ROUNDTABLE) AND THE AMERICAN INSURANCE ASSOCIATION (AIA)

Ms. PUSEY. Good morning, Chairwoman Biggert, and members of the subcommittee. Thank you for the opportunity to testify on behalf of the American Insurance Association in coordination with the Financial Services Roundtable.

My name is Leigh Ann Pusey, and I am the president and CEO of AIA.

I want to focus today on a few key priorities that are emerging from the confluence of the regulatory reform discussions that are going on at the international, Federal, and State levels.

Among these are preserving the viability of the U.S. insurance regulatory system, furthering the growth of free and open insurance markets around the world, and underscoring the important role that the Federal Insurance Office can play in keeping U.S. insurers competitive.

This key role is intended to complement the good work of State regulators and of the NEIC. If the FIO functions as written, together they will be able to present a harmonized national voice on international insurance matters.

Now, let me focus on three specific international matters.

First, while there is a robust discussion, as we have discussed at this table on the previous panel, under way here in the United States over the SIFI designation, there is also the parallel international process determining so-called global SIFIs, or G-SIFIs.

We must ensure that this process accounts for the unique nature of insurance, and it is fair, transparent, and above all does not overtake Dodd-Frank implementation efforts.

It is critical to note that the insurance industry emerged from the recent financial crisis safe and strong. This resilience is a testament to the industry's business model and its regulatory standards. And it must be taken into account in any determination process.

Second, we share a common goal in ensuring that the U.S. insurance regulatory system is viewed as equivalent to the E.U.'s Solvency II initiative, recognizing however that those standards may not be identical.

Third, we have a mutual interest in broadening market access, reducing trade barriers, and ensuring that regulatory initiatives do not impair private markets.

And finally, as others have mentioned, we have a significant concern regarding Section 619 regulations under Dodd-Frank, the so-called Volcker Rule. We are hopeful that when rules are proposed, they will clarify that investments that are held in general and investment accounts of insurers are excluded from the rule.

AIA is leading U.S. property casualty efforts to engage at the international level on a wide range of proposed financial standards. While some may view the current global debate as affecting only those companies that venture outside the United States, the plain truth is that the emerging financial regulation could impact all companies, whether or not they are engaged in foreign markets.

One of those initiatives is the European Union's Solvency II, which is not simply a financial regulatory tool, but a comprehensive restructuring of regulation. Solvency II contains a third country equivalence process that has been the principle source of pressure for our regulators here in the United States.

The consequences of a negative equivalence determination, including having to meet solvency requirements without counting U.S. capital, are potentially severe, both for U.S. insurers doing business in E.U. countries and for E.U.-based insurers with U.S. operations. Therefore, it is critical for the U.S. system to be deemed equivalent under Solvency II.

Apart from Solvency II and similar initiatives, the crisis has generated a global debate about systemic risk. And at the international level, the global SIFI process is being led by the G-20, which has turned to the Financial Stability Board to coordinate proposals for addressing global systemic risk.

As AIA and others at this table have outlined in letters to Capitol Hill and the Administration, there are a number of dangers associated with the G-20 designation of insurers. Any global process must recognize the unique nature of insurance and should focus on those unregulated shadow financial activities.

Finally, barriers to market access, usually through regulation, continue to be a major issue. We are strong supporters of the three pending free trade agreements. And once in effect, we believe they would open markets with large growth opportunities for U.S. insurers.

In each of these discussions, whether it is Solvency II, the G-SIFI process, or market access, it is vitally important for the Federal Insurance Office to be at the table alongside other key representatives, providing a unified national voice for insurers.

Congress envisioned this role for the FIO when it authorized the office to coordinate Federal policy and Federal efforts on prudential insurance matters, represent the United States before the International Association of Insurance Supervisors, assist the Treasury in negotiating bilateral or multilateral insurance agreements on prudential issues, and make recommendations to the FSOC regarding SIFI designation and insurers.

This is the role the FIO is uniquely qualified to fill.

In summary, let me underscore an important message. The insurance industry emerged from the financial crisis in a strong position. But today, despite our strengths, we face regulatory challenges on the international stage that may adversely impact our business model and regulatory structure if not managed.

Now, more than ever, we need the U.S. Government and our State regulators working together to help create a level playing field globally where U.S. insurers can compete and take advantage of new market opportunities.

Thanks again for the opportunity to testify. I would be happy to take any questions.

[The prepared statement of Ms. Pusey can be found on page 123 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Furgatch, you are recognized for 5 minutes.

STATEMENT OF ANDREW FURGATCH, CHAIRMAN AND CEO, MAGNA CARTA COMPANIES, ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI) AND THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC)

Mr. FURGATCH. Thank you, and good morning, Chairwoman Biggert, and the remaining members of the subcommittee who are present.

My name is Andrew Furgatch. I am chairman and CEO of Magna Carta Companies.

Magna Carta was founded in New York in 1925 as a mutual insurance carrier for underwriting property and casualty business. Today, we are licensed in all 50 States and we employ 240 individual in offices in 9 of those States.

I am pleased to testify today on behalf of the PCI and NAMIC, two leading trade associations that together represent almost 70 percent of the property and casualty insurance market and have almost 2,000 member companies.

I have two overarching messages to deliver today. The first is that the U.S. insurance industry is healthy and stable, and is also a stable provider of jobs for the U.S. economy.

The second message is that our industry's ability to continue to manage risk and create jobs is being threatened by a dramatic expansion of new government regulations at the State, Federal, and international levels. The number and complexity of new compliance requirements is driving up marketplace costs and ultimately detracting from growth.

Our plea to this committee is that you use your oversight and legislative authority to restrain non-insurance regulators from overly broad rulemaking and mission creep into the business of insurance as they rush to meet Dodd-Frank Act and international regulatory deadlines.

The nature of P and C insurance products, the industry's low leverage ratios, its relatively liquid assets, and the lack of concentrations in the marketplace make our industry truly unique within the financial services sector, as well as even within the insurance sector.

We operate in an extremely competitive marketplace, and our business model focuses on serving our policyholders by providing critical quality protection to all Americans at competitive prices.

We believe that the regulation of P and C insurance has worked well in the States. For example, the State-based system proved to be effective during the recent financial crisis.

The fiscally prudent regulatory oversight by the States safeguarded insurance consumers and ensured the financial strength of P and C insurance markets. Indeed, insurance regulation was one of the few bright spots in the International Monetary Fund's global review of financial services regulation.

Our chief concern as we go forward is the prevention of any onerous or duplicative regulation of our already heavily regulated industry. Recent laws such as Dodd-Frank directly and indirectly affect P and C insurers.

Now, although my written testimony that was previously submitted touches on many different concerns, I just want to highlight a few here.

First among them is the ability of the new Financial Services Oversight Council to inappropriately sweep insurance into the regulation of highly leveraged, systemically risky banking activities. Traditional P and C insurance is not systemically risky, and it did not play a role in causing the recent financial crisis.

Simply put, our primary risk exposure is directly related to Mother Nature: earthquakes; hurricanes; and natural catastrophes. And it is not correlated with the financial markets.

We are concerned that FSOC and other Federal regulators may use inappropriate and bank-centric metrics when analyzing insurers, thereby subjecting them to burdensome and costly additional regulation.

We are also concerned about the proliferation of new Federal entities that could potentially affect our industry, namely, the Federal Insurance Office, the Office of Financial Research, and the Consumer Financial Protection Bureau.

The FIO and the CFPB should stay true to their legislative intent and not try to exert direct or indirect regulatory authority over insurance activities. Dodd-Frank explicitly states that the FIO and the CFPB are not to regulate insurance, and there is concern that they may seek to find backdoor ways to do so.

The FIO and the OFR, on the other hand, should not be permitted to impose costly data calls on insurers without first seeking needed information from State regulators and other public sources as they are required to do so under the Dodd-Frank Act. Therefore, we strongly urge Congress to monitor these offices closely to ensure compliance with your direction.

Increasing threats to the insurance marketplace also include numerous and new burdensome standards developed by unelected and unaccountable international organizations. What started out as discussions about merely fostering cooperation between international regulators is rapidly evolving into efforts to impose binding new global standards on insurers right here in the United States.

While U.S. Federal bank and State insurance regulators are involved in developing the new regulatory standards, the concerns of those U.S. participants are not always heeded. This abdication of State and Federal legislative control is very disconcerting to our industry.

We urge the committee to vigilantly guard the exceptional competitiveness of the U.S. insurance marketplace and restrain the rush towards bank-centric international rules that add unnecessary layers of cost and oversight to our industry.

In closing, I would like to say the health and stability of the insurance industry depends on Congress' ability to oversee Federal regulators in charge of the implementation of Dodd-Frank. In order for us to continue to protect our policyholders, create the jobs that we are looking for, and be the foundation of a dynamic economy, these Federal regulators should refrain from intruding into the business of insurance.

Thank you again for the opportunity to be here today.

[The prepared statement of Mr. Furgatch can be found on page 60 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Jackson, you are recognized for 5 minutes.

STATEMENT OF CLAY JACKSON, CPCU, SENIOR VICE PRESIDENT AND REGIONAL AGENCY MANAGER, BB&T COOPER, LOVE, JACKSON, THORNTON & HARWELL, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA (IIABA) AND THE COUNCIL OF INSURANCE AGENTS & BROKERS (CIAB)

Mr. JACKSON. Madam Chairwoman and members of the committee, thank you.

I am Clay Jackson, senior vice president of BB&T Insurance Services, the Nation's 6th largest brokerage firm.

My testimony is on behalf of the Independent Insurance Agents and Brokers of America as well as the Council of Insurance Agents and Brokers.

These two organizations span the overwhelming majority of producers of property and casualty insurance across the country, selling both personal lines and commercial insurance. My organization is a member of both.

There have been historic distinctions between large regional and national brokerages and independent agencies with respect to some public affairs positions. But I can say with confidence that the differences between these associations are far outweighed by its common goals.

I would like to make two points today. First, we think there is a significant consensus among all of the private stakeholders on the issue of agent-broker licensure reform, specifically, the NARAB II legislation that has been put forth on a bipartisan basis by Congressmen Neugebauer and Scott, and supported by many members of the committee.

This legislation has twice passed the House of Representatives by overwhelming votes. We encourage you to advance this legislation once again and to help enact it into law.

We work in a business that is increasingly interstate and international. In response to the original NARAB provisions of the Gramm-Leach-Bliley Act, States adopted reforms to encourage reciprocity on nonresident licensure.

But the reforms have simply not gone far enough. There are still far too many State by State distinctions and bureaucratic requirements to add cost to consumers and insurance products without providing value or assuring professionalism of those who are selling those products.

The creation of the National Association of Registered Agents and Brokers, or NARAB, would resolve this problem. Agents and brokers who desire passport for interstate licensure would have to be licensed in their home States, fully subject to their home State laws, and then submit themselves to a higher standard for NARAB membership which would afford them an opportunity to obtain nonresident licenses in other jurisdictions.

The organization would pay for itself, be purely voluntary, and would assure strong standards of professionalism. The producer community across-the-board supports this measure, and we look forward to working with Members of Congress in assuring the creation of an interstate agent-broker licensing system. It just makes common sense.

My final point has to do with the State implementation of the Dodd-Frank provisions regarding surplus lines insurance. Unlike so much else in Dodd-Frank, these provisions were widely supported on both sides of the aisle, and we are deeply appreciative of the members of this committee who were helpful in getting this signed into law.

Surplus lines insurance represents about a third of the commercial insurance marketplace, involving insurance risks that tend to be more sophisticated, exotic, and are largely commercial.

The surplus lines provisions of Dodd-Frank made it clear that the only rules that would govern a multi-State placement of surplus lines products, are the rules of the home State of the insured. This is simple and straightforward. And again, all of the major stakeholders supported these provisions.

The application of this simple rule to the payment of surplus lines premium taxes has led to significant marketplace discord. Some States have agreed only to a sharing formula for premium taxes. Some States have signed on to a compact that would govern all aspects of a surplus lines transaction, and we are particularly appreciative of Kentucky's efforts to help ensure that the multi-State tax allocation is as rational and efficient as possible.

Other States, especially some big States, will retain 100 percent of the premium taxes for insureds headquartered in their jurisdictions. We think the single State tax retention model is probably best. It minimizes the administrative costs for both regulators and producers and should result in an overall increase in premium tax collections.

Given that a single, harmonious regulatory system seems beyond reach at this point, we ask you to urge the States to seriously consider this path.

We think the surplus line situation is good evidence there is justification for limited Federal reforms. It is indeed difficult for States to coordinate and streamline and harmonize in the absence of a broader political dynamic.

Surplus lines reform will ultimately be good reform for all of us. Likewise, the NARAB II proposal is a modest, thoughtful bipartisan piece of legislation that merits enactment.

Thank you for the opportunity to express our views. I appreciate it.

[The prepared statement of Mr. Jackson can be found on page 117 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Jackson.

Mr. Smith, you are recognized for 5 minutes.

STATEMENT OF ERIC SMITH, PRESIDENT AND CEO, SWISS RE AMERICAS, ON BEHALF OF THE REINSURANCE ASSOCIATION OF AMERICA (RAA)

Mr. SMITH. Thank you.

Chairwoman Biggert and members of the subcommittee, on behalf of the Reinsurance Association of America, and my company Swiss Re, thank you for this opportunity to testify.

My name is Eric Smith. I am the president and CEO of Swiss Re Americas.

Swiss Re is a global reinsurance company with a highly skilled workforce of several thousand U.S. employees. We transact business through U.S. taxpaying entities. The RAA is a U.S. national trade association, representing the interest of reinsurers.

Reinsurance is an efficient risk management tool that helps insurance companies and governments with improving their insurance capacity and enhancing financial security. For example, 60 percent of the insured losses related to the attacks of September 11th were absorbed by the global reinsurance industry.

In 2005, 61 percent of the insured losses from hurricanes Katrina, Rita, and Wilma were ultimately borne by reinsurers. And in 2008, approximately one-third of the insured losses from hurricanes Ike and Gustav were reinsured.

We applaud your creation of the FIO and offer our strong support for its establishment. We would like to share a few observations about the new office.

For the first time, there is a Federal agency responsible for understanding the insurance and reinsurance industry. We urge Congress and the Administration to provide sufficient resources to ensure that the FIO can carry out the responsibilities it has been given.

When using its data collection authority, we believe the FIO should coordinate closely with the Office of Financial Research, the NAIC and other existing regulatory and non-regulatory sources to make use of credible data and avoid duplicative reporting.

We also believe the FIO is required to address States' implementation of Sections 531 and 532 of the Dodd-Frank Act and the related reinsurance collateral reform efforts in its statutory reports to Congress.

One important power that Congress granted the FIO is the authority to enter into and enforce international agreements with foreign governments on prudential insurance regulatory matters. This authority should be used to ensure equitable treatment of internationally active insurers and reinsurers and to promote economic growth and job creation here in the United States.

Whether it is discussing an international agreement or participating in a meeting of regulators from other countries, the FIO must be the clear and consistent voice of the United States on insurance-related issues internationally reflecting the interest of U.S. policyholders, insurers, reinsurers, and U.S. insurance regulators.

This subcommittee knows that FSOC is empowered to evaluate and designate nonbank financial institutions as systemically relevant, and subject those companies to additional regulatory scrutiny. In order for a nonbank financial company to be designated systemically relevant, the FSOC must find that the financial stress or the ongoing activities of the company could pose a threat to the financial stability of the United States.

This high standard was set by Congress to prevent unintended consequences resulting from uninformed systemic risk designations which could have lasting effects on a company, its employees, and shareowners in the U.S. economy.

We urge the FSOC to delink all considerations for designating insurance companies from those used for banking institutions. The business models and roles in society of insurance companies and banks are distinct and should be considered separately.

I would like to close with a couple of important lessons learned from the financial crisis.

First, the significant gap in U.S. supervision of company groups must be closed in insurance regulation. A single regulator must be responsible for understanding and regulating a group.

Second, systemic risk regulators must consider activity first rather than entities first if they hope to effectively identify potentially systemically important nonbank financial institutions.

The RAA has undertaken extensive, quantitative, systematic risk analysis using nonbank criteria proposed by systemic risk regulators as the basis for the work. The findings are part of our statement for the record.

On behalf of the Reinsurance Association of America, and my company, Swiss Re, thank you for the opportunity to appear before the subcommittee.

We are gratified that Congress continues to remain engaged in insurance related matters.

[The prepared statement of Mr. Smith can be found on page 136 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

We will now turn to our questions. And I will recognize myself for 5 minutes.

Ms. Heaton, before I really start my questions I think that you had a closing point that was important and probably not in your testimony, if you could conclude with that.

Thank you.

Ms. HEATON. Thank you, Chairwoman Biggert, for your time and giving me the opportunity to really restate our conclusion.

It sounds to us like there has been a lot of progress today as a result of NAIC and NCOIL's testimony, and a realization that the current allocation methods may not be as practical as originally thought by some parties.

And we hope that as a result of this discussion, and your listening to our testimony, that we will be able to harmonize and come to an approach that would meet all of our constituents' needs.

I think the single primary basis behind our concern is that part of what is being required in the NIMA allocation methodology is the collection of data that is not normally part of the underwriting process in the placement of risk. And that would add an additional burden to brokers and companies who provide this coverage.

Chairwoman BIGGERT. Thank you very much. I guess we could say they did hug.

Ms. HEATON. Yes.

Chairwoman BIGGERT. Hopefully, that will work out.

Then, Mr. Furgatch?

Mr. FURGATCH. Yes.

Chairwoman BIGGERT. You represent almost 70 percent of the property casualty insurance industry, ranging from national writers to very small local writers.

And while your company is not at risk of being considered significantly—systematically—I have too many “S’s” here—systemically significant, can you describe for the committee the competitive disadvantages and other impacts on your company if FSOC were to designate any property casualty insurer as a systemically important financial institution?

Mr. FURGATCH. Yes, indeed, we have identified areas where we think there will be a competitive disadvantage. Chief among them is if there are particular companies that are identified as such.

They may be viewed as too-big-to-fail by consumers, giving them a false sense of security, and leading them to be more likely to do business with those firms, thinking there may be a Federal backstop.

Similarly, in the cost of funds area in terms of borrowing or raising capital, it might give those particular companies, identified as such, as a competitive advantage as well.

Chairwoman BIGGERT. Thank you.

Do you think that the $50 billion has any effect or that the insurance companies might fall under that or they are not wanting to increase their size for that reason?

Mr. FURGATCH. Certainly, there would be deterrent there as well. It probably wouldn’t be difficult for firms of that size. They are typically multi-national, and they could perhaps move their assets around to other jurisdictions.

Chairwoman BIGGERT. Thank you.

Ms. Pusey, what do you think of the impact on the Dodd-Frank Act known as the Volcker Rule will be on domestic insurance companies?

And do you think that the language in the section to exempt insurance funds held in separate accounts provides sufficient protection and certainty for insurance companies to conduct their long-term investment and protection, and certainly for insurance companies to go ahead and have long-term investment and risk-hedging activities?

Ms. PUSEY. Thanks for asking the question.

I think that Dodd-Frank went a long way in already acknowledging that insurance operated differently and should be treated differently with respect to the Volcker Rule. We appreciate that, and there are studies under way, etc.

I think with respect to the way of the treatment of these accounts, we think it would be consistent with the intent to recognize that insurers with those kinds of accounts are doing so in a different way than the banks and other financial entities.

It is our hope that they would clarify that in their forthcoming regs on that, and we think it is consistent with the intent of the legislation.

Chairwoman BIGGERT. Do you think that the restrictions that are placed on insurers by the rule will help or hurt U.S. companies to compete in the global marketplace?

Ms. PUSEY. I think there is no question. In fact, I think there was a GAO study released recently that underscored that it would be a threat to competitiveness as the United States is the only country currently contemplating such restrictions.

So, yes, ma'am, I think we do feel it would restrict and be a burden on the competitiveness of U.S. companies.

Chairwoman BIGGERT. Do you think that Congress needs to clarify the insurance exception?

Ms. PUSEY. I will ask—I know there are some other members are looking at Gary Hughes here, who has a lot of companies that are interested in this as well. I think at this point, we would be hopeful that there would be clarification through the reg process and not a need to return to any further legislative—

Chairwoman BIGGERT. Okay.

And now, I will turn to Mr. Hughes.

Mr. HUGHES. I think our feeling that is at this point the rulemaking on Volcker has clarified some of the areas that you have mentioned—proprietary trading, where it is the general account or the separate account of an insurer. There are some outstanding issues.

But it seems to—the intent, which is not to inappropriately disrupt legitimate business practices, seems to be carrying through at this point.

Chairwoman BIGGERT. Thank you.

My time has expired.

I yield to Mr. Hurt for 5 minutes.

Mr. HURT. Thank you, Madam Chairwoman.

I thank each of you for being here and for your testimony today.

I wanted to first ask Mr. Birnbaum a quick question.

In your testimony, you talked about the forced placed insurance, and I was, I think, relieved to hear you say that while you think that there is inadequate regulation now, you believe that forced placed, or that the CFPB "should be given the authority to regulate this issue."

I guess my question to you is, I assume that means that you don't believe that CFPB currently has that authority. Is that a fair statement?

Mr. BIRNBAUM. Yes, I think that is pretty clear.

As the legislation was winding its way through Congress, there was a specific provision taken out that gave the CFPB authority to regulate credit-related insurance. So, I think that is pretty clear.

Where it gets a little murky is that the CFPB does have authority to regulate lenders and lenders' practices, so if lenders' practices deal with lender-placed insurance, they certainly can't deal with rates, but they could deal with the servicing practice.

Mr. HURT. Okay. And that is my next question, do you see any basis at all, as you sit here today, to support that? And maybe that is the answer to your question.

But do you see, in addition to what you have just said, any other basis by which CFPB would be able to regulate this, absent explicit legislative authority given by the United States Congress?

Mr. BIRNBAUM. Yes, I think to the extent that the placement and the servicing of lender-placed insurance is part of the lending process, then I think the CFPB has the same authority for that as they would over any other type of mortgage servicing practices.

They certainly don't have authority over insurance, but they—I think the Dodd-Frank Act does give them authority over mortgage servicing practices.

Mr. HURT. Okay. Thank you.

I also wanted to thank you for what you talked about in terms of the importance of jobs here, because I come from the 5th District of Virginia, where we have suffered tremendous job loss. And it is not—and, frankly and fortunately, it is not anything new, I guess, since 2008.

And certainly, as we look to the Federal Insurance Office—and this is a question I was hoping—I wish everyone could answer it, but my time is going to be limited, but I wanted Mr. Furgatch and Mr. Jackson, perhaps, to address this.

To me, as I go across Virginia's 5th District, and I think this is true for the—if one goes across this country, small business is the backbone of our economy.

And unnecessary—while regulation can be—is important—proper regulation—I think we would probably all agree that unnecessary regulation adds additional cost to small business that either makes it impossible for them to survive or makes an impossible barrier to entry into the marketplace.

And that is what, I think, consumers depend upon in terms of competition, and certainly depend upon those same businesses for their livelihoods.

So I was wondering if Mr. Furgatch first, and then Mr. Jackson, could maybe talk a little bit about as you look at this FIO. And I think we all—I think I understand the importance of having this Federal Insurance Office, although I am very concerned that it is the proverbial nose under the tent.

And then we see what happens when you create something with good intentions, the next thing you know, 10 years later we are going to have this huge, huge expansion of Federal executive power.

Could you just speak to your concerns about that future landscape for the people that you represent?

Mr. FURGATCH. Absolutely, and thank you for giving me that opportunity.

The FIO can serve a very important function in the international arena, but we share your concerns about whether that mission evolves to be applied domestically in a way that was not intended.

The PCI, one of the trade groups whom I am representing today, engaged the Ward benchmarking company, an independent organization, to do a study of the burden of regulatory cost on small businesses—of insurance companies generally.

And what they found is from 2008 to 2010, in a 2-year period, there was a 38 percent increase in overhead costs associated with regulatory compliance for small businesses, and 14 percent for the larger companies. Combined, it was 18 percent.

But since you asked about small businesses, I point out that the smaller businesses bear the greater brunt of more regulatory oversight.

I will also take this opportunity, even though it is slightly off topic, to remind everyone that in the 2008 financial crisis, over 30 percent of our thrifts failed in the country, and over 10 percent of our banks. But there was not one property casualty insurance company that failed in 2008 as a result of the crisis.

So, while regulation is important and it is appropriate, I think it has been clearly demonstrated that as respects property casualty, we have a sound system with the States that is working. And therefore, if the FIO were to mission creep, if you will, it would really represent duplicative, unnecessary, and costly burdens, especially on the small companies.

Mr. HURT. I ask unanimous consent to allow Mr. Jackson to answer my question, if that is all right, since my time has expired.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. JACKSON. Thank you. And I will be very brief.

I think with the FIO, kind of our viewpoint would be that it has been constrained very tightly through legislation at this point.

Thinking about the small businesses and the burdensome things that have to happen, the State licensure, when we have a client that is in multiple States and agents and brokers have to then go through the process of being licensed in all those different States, that is a very time-consuming, burdensome project.

The company that I am with now, we have a department that handles that. In my previous life, working as an independent broker, so to speak—I still am, but in a much smaller shop—it was very time-consuming. You would have to go to outside resources, a very cost-consuming way of doing business. So, it was very burdensome to the small business owner, in particular.

I am hoping that the NARAB approach is going to be the best approach for small business, too.

Mr. HURT. Thank you.

Mr. JACKSON. I think just as an aside, having represented—having been a member of both these insurance organizations, the Big "I" and CIAB for over 50 years, they don't agree on all issues, but they were certainly championing the cause. So, I appreciate the question.

Thank you.

Mr. HURT. Thank you.

Chairwoman BIGGERT. Mr. Sherman, would you like—

Mr. SHERMAN. Thank you. In all fairness—

Chairwoman BIGGERT. Fine.

The gentlelady from West Virginia—

Mrs. CAPITO. Thank you, Madam Chairwoman, and I apologize for not being here for the witnesses' testimony.

I just have a couple of questions.

As you might know, I am the chair of the subcommittee on the banking institutions. And a lot of what we have been dealing with there is CFPB and this FSOC oversight.

There are two insurance companies that are falling into this realm. Can you tell me which ones they are? And I think—are they members of the Big "I?"

Do you know?

Mr. JACKSON. There—

Mrs. CAPITO. There is no insurance company. It is going—

Mr. JACKSON. The two trade associations that I am involved with are the Independent Insurance Agents and Brokers and the Council of Insurance Agents and Brokers—

Mrs. CAPITO. Okay. So—

Ms. PUSEY. Was the question are other insurers designated—

Mrs. CAPITO. Yes.

Ms. PUSEY. Okay. There have been no insurers designated. I think there are conversations about the likelihood of certain types of companies, but I think there is some speculation. But I am unaware of any formal designation—

Mrs. CAPITO. Okay.

The provisions that came out—I guess the FSOC came out this week with sort of a warning shot, saying that there is still weakness in the system, in their opinion.

Does that influence any of your folks in the insurance business?

Ms. PUSEY. I am going to take a stab at that. And our understanding of the their annual report was actually, I think, with respect to the property casualty industry, quite an endorsement of our strengths, that, in fact, that we were—had fared well through this crisis.

We had been stress tested, and that we were, in fact, our core insurance activities—and a lot of distinctions between the other activities in the holding company or the core insurance practices. And those core heavily regulated practices are, in fact, not likely to be deemed to be posing a risk.

I think with respect to a broader assessment of gaps, I think everyone here—and you have spoken to that, too—that beyond insurance, I think there is a recognition that I think that is what the FSOC is trying to get its hands around.

But with respect to insurance, and particularly what we would define as the core traditional property casualty product, I think there has been an increasing chorus saying that, in fact, that is not likely to pose the kind of risks we are looking at.

Mrs. CAPITO. I think having a representative with great knowledge of insurance issues on that council probably will be very helpful. And I know that the President's recommendation has gone before the Senate. So, I think that is a good signal and a good sign.

Let me ask you just a general economic question—and anybody can take a stab at this.

What are you finding in terms of the pulse of your business? We know our unemployment is up to 9.2 percent. We know that the issues that we are discussing here, the debt and deficit issues, but the debt ceiling issues are causing fits and starts.

What are you all seeing over the horizon in terms of growth, or expansion, or seized-up markets? I am just interested to see how your economists are looking at the next year here, and what you are seeing right at the present time.

Mr. FURGATCH. I can start off with that.

On behalf of the property casualty insurance industry, I can say that it is functioning. It is functioning well. And it is highly competitive.

With that having been said, the outlook and sentiment is not overly favorable going forward. There is still a lot of uncertainty and instability, in large part related to regulation as well as the debt situation that Congress is grappling with right now.

I want to point out that we had $1 trillion of investment money emanating from the property casualty industry, invested in both government as well as privately issued securities. It is as easy as a point-and-click on a computer nowadays to move those investments out of the United States and into foreign currencies and overseas.

Mrs. CAPITO. Has that occurred over the last—

Mr. FURGATCH. I think the larger, more sophisticated investment portfolios in the industry, on a standard basis, probably diversify by having some overseas securities.

So, the issue is not whether it is a threshold of whether it leaves, but rather a sense of confidence in investing in the United States with the asset side of the balance sheet.

When there is uncertainty, like what is being posed with the debt ceiling, it is an impetus for companies to move more investments into other currencies and overseas.

And my fear is—and I speak not so much as the insurance carrier with this concern, but more as an American, if you will, is that once the infrastructure is established to move these assets overseas, and once that becomes a common practice, even if the U.S. economy rebounds, and even if the government demonstrates responsibility in dealing with the long-term debt issue, that doesn't necessarily mean that all that money comes back.

And so I think some very significant damage can be done, just by the uncertainty that we are all coping with.

Mrs. CAPITO. I appreciate that. Thank you.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you, Ms. Capito.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Thank you.

My first question will be to Mr. Hughes. Insurance companies exist to assume risks that families can't assume themselves or don't want to.

Life insurance is kind of misnamed, in that it is really death insurance. It pays when somebody dies.

But since that name was already used, they came up with the term longevity insurance to insure against living too long. For so many of my constituents, if you ask them what is their economic fear, it is that they will outlive their savings.

So, I can commend your industry for coming up with longevity insurance. The problem is, I don't know if any of your members are offering inflation-adjusted longevity insurance.

In the absence of inflation adjustment, longevity insurance doesn't achieve its purpose.

I have talked to some in your industry who have said, inflation, that is a risk. We don't want to take that. In which case, if the insurance industry isn't in the business of taking risks, why do you exist?

Have you been able to persuade any of your members to offer the product that so many people in this country—they don't describe it this way.

The fear is, I will outlive my savings. The more sophisticated fear is, I will outlive my savings, or there will be a lot of inflation, and I will outlive my savings.

Any of your members offering longevity insurance that is inflation adjusted?

Mr. HUGHES. I think I would answer that question by saying the business of life insurance companies is really in two primary areas, life insurance and annuities. And it is the annuity product that is the product—

Mr. SHERMAN. Yes. Okay, are you offering—

Mr. HUGHES. —with your assets. And variable annuity is designed as a hedge against inflation.

Mr. SHERMAN. But that is not a guarantee against inflation, that is dependent upon the success of the U.S. stock market. Obviously, longevity insurance is an annuity and I am glad your industry offers an annuity.

It is fine that you have a product that is keyed to the U.S. stock market, but that is hardly assurance that when a person lives beyond what used to be considered a ripe old age, that they will actually be able to buy groceries.

Mr. HUGHES. Well, if—

Mr. SHERMAN. I am not so sure the U.S. stock market is—in any case, are any of your companies offering inflation-adjusted annuities that start at age 80 or age 85?

Mr. HUGHES. You know—

Mr. SHERMAN. I know you will get back to me for the record, and I thank you for your patience with my question.

And then—but the follow-up question will be this—if your first answer is no, then for the record, please say what does Congress have to do to get you folks to offer a product—and you can't say people won't buy it, because they will if they understand it.

It won't look as attractive as your other products, because you are—obviously an inflation-adjusted annuity is a smaller dollar amount adjusted for inflation, may turn out to be a bigger dollar amount come 20 or 30 years from now or 40 years from now.

So, my first question for the record is—are your companies offering inflation-adjusted longevity insurance. And second, if not, why not; and third, what does Congress have to do to change the answer to the first question? And I—

Mr. HUGHES. My interpretation—

Mr. SHERMAN. —since you had no reason to think that I would be asking this question—

Mr. HUGHES. No, I had—

Mr. SHERMAN. —I have no reason to expect an off-the-cuff answer.

Now, let me shift to Ms. Heaton.

And this, I think, may be a question you would expect, because we have the Nonadmitted Multi-State Agreement.

Some have said this agreement would create new regulatory burdens that did not exist previously to the Nonadmitted Reinsurance Reform Act. And that the agreement really isn't based on existing data.

What do you think of the agreement?

Ms. HEATON. I am sorry, I didn't hear—

Mr. SHERMAN. What do you think of the Nonadmitted Multi-State Agreement?

Ms. HEATON. I think perhaps you weren't with us at the time, but Kentucky and SLIMPACT have proposed compacts—interstate compacts that we think reflect the spirit of NRRA in that they are consistent amongst the States, making a one-State filing process available to brokers and the companies that support the sale of our insurance.

And we think that is a better solution than what has been previously proposed by NIMA and the NAIC.

Earlier today, we saw NCOIL and NAIC hug on this table, so we are highly optimistic that our differences will get resolved.

Mr. SHERMAN. I don't know that I am happy or unhappy not to see whatever happened on that table happen. I am sure you are—this was figurative hugging or literal?

Ms. HEATON. No, literally, they hugged, and they said they would be hugging out in the hall, too. So, we are very optimistic that this will get resolved.

Mr. SHERMAN. C-SPAN ratings will improve.

Ms. HEATON. Yes.

Mr. SHERMAN. I thank you for your answer, and like my colleague, regret that I wasn't here earlier in the hearing, and I yield back.

Chairwoman BIGGERT. Thank you, Mr. Sherman.

Mr. Smith, I am going to recognize myself to ask another question.

In your testimony on behalf of RAA and Swiss Re, you have attached some research from the RAA on the question of systemic risk and the reinsurance business.

We also know that FSOC has announced that it expects to release additional guidance regarding the criteria that the FSOC may use to determine if a business is a SIFI.

Knowing this, could you summarize the conclusion of the research that you have on this matter?

Mr. SMITH. Yes. Thank you.

The general finding of the research is that reinsurers and reinsurance, they are not the source of systemic risk. But the additional thought—I know it has been brought up numerous times this morning—we must look at the activities of entities, not their size.

It is all about the activities. It is all about leverage. That is the key.

Chairwoman BIGGERT. Great. Thank you. That was a quick answer.

Mr. Hughes?

I understand that various segments of the insurance industry are very concerned with the Department of Labor's recent proposal regulation which would change who would be a fiduciary. It is a duty of a—fiduciary for the purpose of giving investment advice.

A number of stakeholders have said that this regulation should be withdrawn and re-proposed. How could the proposed deal or rule impact the insurance industry and consumers?

Mr. HUGHES. First, we would certainly like to thank you for your involvement in that issue. It has been very helpful and much appreciated.

The concern we have is that the Department of Labor proposed the rule. There really wasn't any demonstrated need, at least that we saw in the proposal.

And the problem that we see is it is going to drive up the cost of valuable advice to plan participants and IRA holders, and limit the ability of that investment advice.

As you have noted, the process we think can only be cured by re-proposing the rule. And in terms of timing, it has been a bit frustrating to see the SEC looking at its own issues of harmonizing the standards for broker dealers and investment advisors. And that is going to be a fiduciary standard, and the Department of Labor not coordinating their effort at all with the SEC.

So we think in terms of timing, in terms of substance and in terms of process, a re-proposal of the rule is the only way to really handle that issue appropriately.

Chairwoman BIGGERT. Thank you.

I know that we tried to make sure that the two agencies are working together. Maybe we could get them to hug, too. I don't know.

But I think it is a very important issue. And it really does concern us. I think that there will be a conflict between these. And this is a very important issue. So thank you.

With that, seeing no one else here, I will thank the panel and note that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And I would really like, again, to thank the witnesses for joining us today.

I would also like to announce that we plan to hold a similar insurance oversight hearing in the fall to hear from the new FIO Director and perhaps other Federal regulators on many of the topics that were discussed today. And I hope that Mr. McRaith will be able to be here and will have finished his orientation by that time.

So again, thank you so much for being here.

And with that, this hearing is adjourned.

[Whereupon, at 12:29 p.m., the hearing was adjourned.]

A P P E N D I X

July 28, 2011

Testimony of Birny Birnbaum
Executive Director
Center for Economic Justice

Before the

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives

"Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs"

July 28, 2011

Chairman Biggert, Ranking Member Gutierrez and members of the Subcommittee, my name is Birny Birnbaum. I am the Executive Director of the Center for Economic Justice, a non-profit organization advocating on behalf of consumers on insurance, credit and utility issues. I have been intimately involved in insurance regulatory policy issues for 20 years as a regulator and as a consumer representative. I have been an active participant at the National Association of Insurance Commissions (NAIC) and the National Conference of Insurance Legislators (NCOIL) for many years.

The vast majority of state insurance regulators – particularly those in market regulation – are incredibly dedicated to consumer protection. I have had the honor of working with hundreds of these state insurance regulators over the past 20 years. But these regulators are limited by a lack of essential tools – data for market analysis – and by a regulatory structure that favors insurers over consumers. There are some clear actions states can take to level the insurance regulatory playing field and make regulators and insurers more accountable to consumers.

My testimony today will cover:

- Accountability and Responsiveness of Insurance Regulators and Insurers to Consumers
- The Limitations of State Insurance Market Regulation Efforts
- The Dodd Frank Requirements for Studies of Insurance Availability
- Problems with Force-Placed Homeowners Insurance

Accountability of Regulators and Insurers to Consumers

The insurance regulatory system has limited accountability to consumers and routinely favors insurance industry interests over consumer interests.

There is a tremendous imbalance in the ability of the insurance industry – versus consumers – to influence insurance regulatory policy and regulatory performance. The insurance industry spends hundreds of millions of dollars of funds provided by consumers – paid as part of the insurance premiums – to lobby regulators and legislators at the NAIC, NCOIL and in individual states. In the vast majority of states, there are no consumer organizations focusing on insurance issues other than health insurance. So, for the vast majority of regulatory issues, there are no consumer perspectives to balance out the many industry voices pushing for the industry policies. Even when there is a consumer voice, it is typically outnumbered and outspent by massive amounts.

Today's hearing is an example of this imbalance. Six industry representatives representing nine industry trade associations are testifying today. I am the sole consumer representative.

The absence of consumer insurance advocates – individuals and institutions with resources necessary to participate in the regulatory process – contributes to an insurance regulatory system that is far more accountable to industry than to consumers. This is most pronounced for state insurance regulatory administrative actions – rulemaking, enforcement and market surveillance. Industry has virtually unlimited funds to press their views and fund research to serve their cause – funds provided by policyholders from premium payments. As a result, insurance regulatory policy and actions routinely favors insurers over consumers.

The regulatory bias towards industry is exacerbated by weak conflict of interest requirements regarding movement of regulators to industry. When regulators leave public service, the vast majority go to work for the industry they regulated – often lobbying their former colleagues on behalf of industry. Few go to work on behalf of consumers because there are few jobs available for insurance consumer advocates.

To level the playing field and make insurance regulation more accountable to consumers, insurers should be prohibited from including lobbying expenses in insurance premiums. Alternatively, insurers should be required to obtain affirmative agreement – opt-in – by consumers for use of premium dollars for lobbying. In addition, there should be mechanisms in place to fund independent insurance consumer advocates. There are a number of models for this, ranging from state agencies like the Texas Office of Public Insurance Counsel to consumer-funded Consumer Insurance Boards. Of course, conflict of interest requirements should also be strengthened to ensure that today's regulatory actions are not influenced by tomorrow's job prospect.

Another critical tool to improve the accountability of insurers and regulators to consumers is the public availability of insurer market performance data – the insurance equivalent of Home Mortgage Disclosure Act Data.

State Insurance Market Regulation

Market regulation is the term used to describe regulators' activities to monitor insurance markets, identify market problems and consumer abuses and remedy those problems. Although one of the most oft-heard arguments for state-based insurance regulation is that the states better understand and are closer to their markets than a federal regulator, the fact is that state regulators have a poor track record of identifying the worst market problems. Indeed, many of the worst insurance consumer abuses were identified by others – state attorneys general, news media or consumers going to lawyers for assistance. The list of market problems not identified by state insurance regulators is impressive:

- Bid Rigging Associated With Contingent Compensation of Brokers
- Homeowners and Auto Insurance Redlining
- Financed Single Premium Credit Insurance Sold With Real Estate Loans
- Churning of Life Insurance Policies
- Unsuitable Sales of Annuities to Seniors
- Life Insurer Claim Settlement Practices and Retained Asset Accounts
- Unfair Underwriting and Rating Factors

The limitations of state insurance market regulation have been recognized by the Government Accountability Office (GAO) and by Congress. The GAO has issues several reports examining state insurance regulation. In a 2003 report[1], the GAO stated:

> While all states do some kinds of market regulation, including issuing licenses and responding to consumer complaints, two key tools—market analysis and on-site examinations—are used inconsistently, if at all. The result is inconsistent and often spotty coverage from state to state and potential gaps in consumer protection. Formal and rigorous market analysis, which could be used to determine which companies to examine and how broad the examination should be, is in its infancy among state regulators, and states that do perform examinations vary widely in the way they choose companies to examine and the scope of the examinations they conduct. These inconsistencies in performing market conduct examinations make it difficult for the states to depend on each other for regulation, leaving each state with the virtually impossible task of examining every company within its borders. And with each state conducting its own examinations, some insurance companies find themselves undergoing simultaneous examinations by several states, while other companies may not be examined at all.

In a follow up report in 2009[2], the GAO found limited improvement and stated, "NAIC and the states have taken steps to improve reciprocity and uniformity of market regulation, but variation across states has limited progress."

Congress has also taken note of the states' failure to examine insurance markets for unfair discrimination. In the 2003, Congress passed the Fair and Accurate Credit Transactions Act, which required the Federal Trade Commission, in consultation with the Office of Fair Housing and Equal Opportunity of HUD to study the effects of credit-based insurance scores on the availability and affordability of property and casualty insurance, the statistical relationship

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[1] "Insurance Regulation: Common Standards and Improved Coordination Needed to Strengthen Market Regulation," General Accounting Office, September 2003

[2] "Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain," Government Accountability Office, April 6, 2009

between credit-based insurance scores and actual losses, and the extent to which credit-based insurance scores are a proxy for prohibited factors, such as race, color, or religion. Despite being responsible for regulating insurers' use of consumer credit information for underwriting and rating, state regulators have collected very little information on, for example, the impact of the great recession on insurance scores and premiums.

More recently, in the Dodd Frank Act, Congress created the Federal Insurance Office (FIO) and authorized the FIO to monitor the extent to which traditionally underserved communities and consumers, minorities and low- and moderate-income persons have access to afford able insurance products regarding all lines of insurance, except health insurance. Congress also gave the FIO the authority to collect data from insurers, to the extent the data is not already collected by state insurance and other regulators.

These directives by Congress are a result of the failure of state insurance regulators to collect meaningful market performance data about insurers. Currently, state regulators receive and review consumer complaints and have started to collect a few pieces of data through the Market Conduct Annual Statement (MCAS). But these data are grossly inadequate for rigorous market surveillance and analysis. The absence of consumer complaints is not a reliable indicator of fair treatment of consumers; some market problems did not produce consumer complaints because the consumer was not aware of the problem (bid rigging/broke compensation, retained asset accounts) or did not know to file a complaint with the insurance department. The MCAS, which has great potential to assist regulators in improving market regulation, fails to meaningfully help regulators because there are so few data elements and the data elements collected are so highly summarized.

The failure of state insurance regulators to collect – and publish – insurer market performance data contrasts starkly with market performance data available to regulators and the public for mortgage and other lending through the Home Mortgage Disclosure Act (HMDA). With HMDA, lenders report information on all loan applications and resulting loans. The availability of HMDA data allowed fair lending organizations to identify predatory lending abuses in the subprime mortgage market as early as the late 1990's and the reckless mortgage lending practices that led to the financial crisis of 2008 in the early 2000's.

One of the most important actions state insurance regulators can take to improve market regulation, consumer protection and accountability of insurers and regulators to the public is to collect and publish detailed market performance data about individual insurers in the same way that HMDA data are collected and published for lenders' market performance.

Force-Placed Insurance

Lender-placed insurance (LPI) is also known as force-placed insurance, is insurance placed by a lender on collateral supporting a consumer loan in the event the borrower fails to maintain required insurance coverage. For example, a mortgage lender will require property insurance to protect the real estate serving as collateral for the loan. Lenders (or, more typically, the insurer providing the LPI and administering the program for the lender) monitor the insurance status of the property and auto loans to ensure the required insurance is in place. If the lender or insurer/program administrator determines the insurance is not in place, an insurance policy (or certificate on a group policy) is issued to cover the property or auto. The cost of the force-placed insurance is added to the loan.

The incentives and potential for abuse in the administration of LPI are great. Consumers do not request the insurance, but are forced to pay for it. The cost of LPI is much higher than a policy the borrower would purchase on his or her own. Lenders have incentive to force-place the insurance because the premium includes a commission to the lender and, in some cases, the insurance is reinsured through a captive reinsurer of the lender, resulting in additional revenue to the lender from the force-placement of the coverage.

With the great problems in the mortgage market and the crushing impact on low- and moderate-income consumers of the recession caused by the financial market collapse, the amount of force-placed homeowners insurance has exploded in recent years. According to Credit Insurance Experience Exhibit (CIEE) Data, insurers wrote $1.5 billion of gross premium in 2004. By

2009, that amount had grown to over $5 billion and, in 2010, LPI gross written premium grew to over $5.5 billion.

The prices for residential property LPI are significantly excessive. In 2009, insurers paid only 16% of net premium in claims and in 2010 the ratio was 17%. Incredibly, lenders get a commission – totaling hundreds of millions of dollars – out of these premiums, despite the fact that the insurance is placed to protect the lenders' collateral. The premiums also include the costs of tracking all the loans in the lenders' portfolios to identify those loans without insurance – so the lenders' cost of tracking all loans is passed only to those consumers paying for force-place insurance.

The problems with force-placed insurance illustrate a number of state regulatory failures. In this instance, regulators collect the data to indicate a problem with overcharges. But, state regulators have not taken action on their own initiative to reduce the rates for LPI. The problems with LPI have been brought to regulators' attention – at NAIC meetings and in correspondence with individual state regulators – but regulators have not taken action in response to the problems raised by consumers. Problems other than excessive rates were not identified by regulators, but by reporters[3] and consumer representatives because regulators collect no data on the sales practices and servicing practices of the handful of insurers writing the vast majority of the LPI business.

While the problems with insurance market regulation are significant, there are some clear actions, as described in my testimony, states can take to level the insurance regulatory playing field and make regulators and insurers more accountable to consumers.

[3] "Ties to Insurers Could Land Mortgage Services in More Trouble," Jeff Horwitz, *American Bankers*, November 10, 2010.

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Birny has authored reports on insurance markets, credit scoring, redlining, title insurance and credit insurance for CEJ and other organizations. Birny served on the National Association of Insurance Commissioners Consumer Board of Trustees. Birny has been particularly active on issues involving data collection for market surveillance and market analysis, the role and effectiveness of consumer disclosures and insurance market conduct issues. He has authored reports to numerous public agencies, including the California Department of Insurance, the Florida Insurance Commissioner's Task Force on Credit Scoring, the Ohio Civil Rights Commission and the Cities of New York and Philadelphia.

Birny served for three years as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, Birny provided technical and policy advice to the Commissioner of Insurance and performed policy research and analysis for the Department. Birny was also responsible for the development of data collection programs for market surveillance.

Prior to coming to the Department, Birny was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issue. OPIC is a Texas state agency whose mission is to advocate on behalf of insurance consumers. Prior to OPIC, Birny was a consulting economist working on community and economic development projects. Birny also worked as business and financial analyst for the Port Authority of New York and New Jersey. Birny was educated at Bowdoin College and the Massachusetts Institute of Technology. He holds two Master's Degrees from MIT in Management and in Urban Planning with concentrations is finance and applied economics.

Testimony
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Property Casualty Insurers Association of America (PCI)
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Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives
July 28, 2011

Chairman Biggert and members of the Subcommittee, my name is Andrew Furgatch and I am the Chairman and CEO of Magna Carta Companies. As a member of both the Property Casualty Insurers Association of America (PCI) and the National Association of Mutual Insurance Companies (NAMIC), I am pleased to testify on behalf of Magna Carta and the members of these two dynamic trade associations on the implications of federal and state government policy on the insurance industry, policyholders, and the economy.

Magna Carta was founded in New York City in 1925 as a mutual insurance carrier for the taxicab industry. Today, Magna Carta specializes in underwriting the commercial real estate industry and is one of the largest mutual carriers of commercial business in America. The group now consists of Public Service Mutual Insurance Company, Paramount Insurance Company and Western Select Insurance Company. When the group celebrated its 75-year anniversary in 2000, it adopted the trade name of Magna Carta Companies.

PCI is composed of more than 1,000 member companies, representing a broad cross-section of insurers. PCI members write over $175 billion in annual premium and 37.4 percent of the nation's property casualty insurance. PCI represents 43.5 percent of the US automobile insurance market, 30.6 percent of the homeowners market, 35.3 percent of the commercial property and liability market, and 41.8 percent of the private workers compensation market. PCI is committed to promoting and protecting the viability of a competitive private insurance market for the benefit of consumers and insurers through strategic advocacy efforts on state, federal and international property casualty insurance issues.

NAMIC is a large and diverse national property/casualty insurance trade and political advocacy association, and has been advocating for a strong and vibrant insurance industry since its inception in 1895. Its 1,400 member companies write all lines of property casualty insurance business and include small, single-state, regional, and national carriers accounting for 50 percent of the automobile/homeowners market and 31 percent of the business insurance market.

P/C Insurance Industry Creates Jobs and Makes a Substantial Contribution to the Nation's Economic Health

I have two overarching messages to deliver today. The first is that the US insurance industry is strong and growing, performed very well during the recent financial crisis, and is a significant job creator for the US economy. The second is that our industry's ability to continue to grow and create jobs is being challenged by an explosion of new regulations, especially at the federal and international levels. While some of these may be intended to address legitimate concerns, many are ill-advised efforts to impose bank-centric rules on insurers, which have very different business models than banks. Congress, and this Committee in particular, plays a vital role in overseeing federal financial regulators to ensure that they do not engage in "mission creep" and intrude inappropriately into insurance regulation by adopting a one-size-fits all approach to financial regulation.

The P/C Industry is Strong. Property casualty insurers greatly outperformed other financial sectors during the recent financial crisis. A recent Temple University report analyzed stock performance trends from December 31, 2004 through August 24, 2010 for property casualty insurers, life insurers, banks and the S&P. The findings showed that, from peak-to-trough, the life insurer index lost 85% of its value, the bank index lost 88%, and the S&P 500 lost 57% of value. Property casualty insurers fared better during the crisis, losing "only" 47% of value.

Our industry exists primarily to serve our policyholders, which we do well. We operate in an extremely competitive marketplace with more than 2,500 individual insurance companies providing critical, quality protection to all Americans at competitive prices.

P/C Insurers Create Jobs. The property casualty industry provides over 475,000 jobs across the country, bringing more than $34.4 billion in annual wages into the economy. Property casualty insurers are a major source of capital for state and local government in the United States, investing $369.8 billion in state municipal bonds in 2010, which helps to fund the construction of schools, roads, health care facilities, and a variety of other public projects. In addition, property casualty insurers provided $527 billion to US businesses in 2010 to fund research, innovation, expansion and other opportunities through their investments in corporate stocks and bonds. The insurance industry as a whole (including life/health) contributed $424 billion to the nation's GDP in 2009 (3%) and paid $15.8 billion in state premium taxes in 2010, among a wide range of other state and local taxes.[1]

Threats on the Horizon. Although our industry is performing well, we are concerned that various regulatory developments at the state, federal, and international levels pose potential threats to the future the industry. Congress, and the House Financial Services Committee in particular, need to be alert to these threats and vigilant to act, when needed, to prevent unintended negative consequences that can flow from ill-considered regulatory actions. My testimony will provide some background on the nature of insurance regulation and describe some of the threats on the horizon.

The Evolution of Insurance Regulation

State Regulation Has Worked Well. Since the mid-1800s, US property casualty insurers have been regulated by each of the states in which they conduct business. By adopting the McCarran-Ferguson Act in 1945, Congress endorsed state oversight of insurance. State regulation seeks to ensure that insurers will be solvent to pay their policyholders' claims and protects consumer rights with respect to privacy and insurance coverage. During the recent financial crisis involving troubled banks and securities firms, fiscally prudent regulatory oversight by states was

[1] US Bureau of Labor Statistics; US Bureau of Economic Analysis; Board of Governors of the Federal Reserve System

found to be effective in safeguarding insurance purchasers and ensuring the financial strength of US insurance markets and businesses. Indeed, insurance regulation was one of the bright spots in the International Monetary Fund's review of financial services regulation globally.

One of the many benefits of state regulation is its ability to adapt and respond to each state's unique marketplace and to act as a "laboratory for experimentation" that can identify best practices that can then be adopted elsewhere.

Increased compliance costs resulting from excess layers of regulation are also a growing challenge for insurers. This is true even at the state level, before considering the new federal and international pressures discussed elsewhere in my testimony. The cost of compliance is a significant business issue for insurance companies. Results from a recent PCI/Ward Group survey on the cost of regulatory and corporate compliance found that total compliance expenses grew almost 18 percent from 2008 to 2010. Smaller companies continue to face the most significant challenges due to increased regulatory requirements – from 2008 to 2010, the cost of compliance grew 36 percent for small companies and 14 percent for large companies.

Increasing Federal and International Involvement. In addition to increasing efforts to make state-based regulation more uniform, federal and international regulators are becoming ever more involved in the regulation of US insurers. The Dodd-Frank Act has created a new Federal Insurance Office within Treasury, which will have significant power to collect data about the industry, and potentially to impose costly data demands on insurers. Although the office has no regulatory power, it does have the power to preempt certain state laws, as I describe in more detail later. In addition, regulators from around the world are actively engaged in finding ways to harmonize financial regulation globally, including insurance regulation. While this is usually well-intentioned, the threat is that non-US banking regulators become too influential over matters affecting an industry and a marketplace that they do not understand. Thus, the regulatory threats facing insurers now come not only from the fifty states, but from Washington and foreign capitals as well.

Impact of the Dodd-Frank Act

The Dodd-Frank Act (DFA) was enacted primarily to address regulatory gaps in the financial services sectors that had become apparent in the aftermath of the recent financial crisis, and to prevent financial firms from engaging in activities that pose systemic risk to the economy as a whole. However, it also included other provisions not directly related to systemic risk that impact the insurance industry. Although DFA accommodated state insurance regulation in some critical ways, it did not always adequately acknowledge the unique characteristics of the insurance industry and its regulation that make it inappropriate, and indeed dangerous, for federal regulators to intrude. Instead, DFA established a system for regulating and resolving all financial institutions, too often without explicit exemptions for insurers. The details are left to the federal regulators, meaning that they will often have the power to decide whether to respect state regulation of insurance or not. While some regulators have responded in a sensible way, others have not. This has created substantial uncertainty within the industry about whether new costly, burdensome, bank-centric regulations will be applied to insurers. Such uncertainty tends to discourage investment in new activities, and thus new job growth, at a time when new investment and jobs are sorely needed. Congress should monitor such federal regulatory incursions closely and consider amendments to DFA when necessary to protect our historically effective state regulatory system.

Systemic Risk Regulation and Resolution. The Financial Services Oversight Council (FSOC) is responsible for monitoring financial firms that have the potential to pose "systemic risk" to the economy as a whole so that regulators can intervene to limit highly risky activities, some of which had been relatively unregulated in the past. While this is a worthwhile goal, its success depends on the ability of the FSOC to accurately identify firms posing true systemic risk and to respond to those risks in an appropriate manner. Conversely, regulators must refrain from applying burdensome and costly systemic risk regulation to entities that are not systemically risky, as this only harms those firms without advancing the goal of thwarting systemically risky activities.

Property casualty insurance companies, even large ones, are generally not systemically risky. They do not have the characteristics of systemically risky firms, *i.e.*, they are not highly leveraged, are not highly interconnected with other financial firms, pose no "run on the bank" threat, are highly competitive with low market concentration, have low failure rates, and have an effective regulatory system for resolving those few firms that do fail. Even the failure of a very large property casualty insurer would have no significant impact on the overall US economy. The impact would be limited to a temporary disruption in the property casualty market, which would be quickly ameliorated as other insurers pick up the business of the failed company.

Moreover, state insurance regulators do not permit insurance companies that exist within groups to endanger their own financial stability by subsidizing other financial firms within the group. Assets supporting insurance liabilities are ring-fenced and are unavailable to bail out other affiliated companies. DFA turned this principle on its ear when it allowed regulators to require insurers to serve as a source of strength for troubled non-insurer subsidiaries or affiliates.

Under DFA, some insurers may also be called upon to pay assessments to help defray the government's costs in resolving non-insurer financial firms. Forcing insurers to subsidize the federal system for resolving failed banking and securities firms (with no subsidies running from those companies to insurers) is unfair, but more importantly, it creates a moral hazard and may prompt banks and securities firms to engage in riskier activities than might otherwise be the case if they believed that the costs of those activities would only be borne within their own industry. The insurance industry has its own state-based, self-financed system for resolving failing companies and for ensuring that most policyholders of such companies are made whole. That system does not rely on financial support from other industries. DFA, in contrast, provides that federal regulators can place liens against an insurer's assets, over the objections of state insurance regulators, to secure the assets of an affiliated non-insurer firm.

In part to guard against the imposition of inappropriate, bank-centric regulation to insurers, the Congress wisely chose to include three representatives of the insurance and regulatory communities on the FSOC. The only voting member, however, is an insurance member appointed by the President. Non-voting members are the FIO Director and a state insurance regulator. Roy Woodall has only just been nominated as the insurance expert on the FSOC, and his Senate confirmation hearing was held on Tuesday of this week. The FIO Director, Michael McRaith, just took office last month. Thus, the considerable preliminary work the bank-centric FSOC has already done on systemic risk rules has been conducted without the participation of two of the three insurance representatives who should have been there. Only the insurance regulator, John Huff, has participated in the discussions. Both Mr. Woodall and Mr. McRaith are former insurance regulators who bring a wealth of knowledge and experience to the FSOC.

The Committee should urge that the FSOC refrain from issuing rules affecting insurers until such time as they can be informed by the considerable expertise of <u>all</u> of the insurance representatives on the FSOC. This is an important part of the Committee's overall responsibility to monitor and oversee federal financial regulators to ensure that they do not misuse their regulatory power in ways that are inappropriate and detrimental to insurers and their policyholders and that avoid unnecessary regulatory conflicts between state insurance regulators and federal financial regulators.

Federal Insurance Office (FIO)/Office of Financial Regulation (OFR). The creation of the new Federal Insurance Office marks the first time that the federal government has had any general oversight authority over the insurance industry. While Congress was careful to state that the FIO will have no regulatory authority, it does have substantial powers to study, collect information, and issue reports on various aspects of the insurance industry as well as to preempt state laws in limited circumstances where they conflict with Treasury-negotiated international agreements. One of the most significant potential areas for abuse is FIO's authority to collect information on the insurance industry. This creates the potential for extremely costly and burdensome data calls on insurers, which ultimately negatively impacts consumers. Congress sought to discourage this by providing that all data calls are subject to the cost-benefit requirements of the Paperwork Reduction Act and that the FIO must first go to state regulators and other public sources for information and seek data from insurers only when it is not available elsewhere.

Similarly, the new Office of Financial Regulation (OFR) has substantial power to make data calls on insurers. That office, too, is required to obtain information from state regulators and publicly available sources before going to insurers (and FIO is required to seek information from OFR before seeking it from insurers).

Congress should monitor the activities of both OFR and FIO closely to guard against "mission creep" and to ensure that both agencies remain faithful to their statutory obligations.

Swaps. DFA included language regarding the definition of swaps and derivatives that could have been interpreted to include property casualty insurance contracts. We appreciate the efforts of the SEC and the CFTC to clarify in their rules that property casualty insurance contracts are excluded from the definition of a derivative.

Volcker Rule. DFA sought to impose new rules on banks that would prevent a perceived conflict of interest under which banks trading for their own account favored themselves and disadvantaged their customers. Some early versions of the legislation left open the possibility that these proprietary trading restrictions could be applied to insurers, and would inhibit not only their ability to invest assets responsibly but also state regulators' ability to regulate those investments. As passed, the Volcker Rule included an exemption for activities conducted by a regulated insurance company, though there is still the potential for federal regulators to intervene if they believe state insurance investment regulations do not adequately protect the safety and soundness of an affiliated banking entity or US financial stability. Congress should monitor this carefully to ensure that this limited ability to impose Volcker Rule restrictions on insurers is not used inappropriately.

Surplus Lines. Surplus lines insurers respond to insurance needs where the traditional or state-regulated (admitted) insurance market may not be able to provide coverage for a given type of risk. Congress wisely included provisions in DFA to help streamline compliance with state surplus lines laws on risks located in multiple states. The home state of the insured will generally have exclusive authority to regulate surplus lines transactions, including taxation, but DFA also encourages states to enter into compacts or agreements with other states on how to allocate taxes among states on multi-state risks.

To date, 43 states have enacted legislation to amend their state laws to conform to some or all of the surplus lines provisions of DFA. However, state implementation has been far from uniform, especially with respect to tax allocation. As a result, compliance standards for all stakeholders (insurers, brokers, agents and insureds) are not clear. We urge the Committee to monitor developments closely and to consider whether additional federal pressure on states to achieve uniformity may be needed.

Reinsurance. DFA included some positive provisions designed to streamline the regulation of reinsurance without inappropriate federal intrusion by limiting the authority to regulate certain reinsurance transactions involving multi-state risks to a single state. However, the FIO's authority to preempt state laws that conflict with international agreements negotiated by Treasury is a concern. This authority seems aimed primarily at existing US rules under which foreign reinsurers must post collateral protecting 100% of their liabilities in the US. Foreign reinsurers and governments have put considerable pressure on the US to lower or eliminate these collateral requirements, arguing that they constitute a trade barrier. PCI and NAMIC strongly believe that collateral is important to protect the interests of US insurers who purchase reinsurance from overseas reinsurers. The NAIC is seeking to enact changes to the law that will hopefully strike the right balance between protecting the interests of US insurers and addressing the complaints of foreign governments and reinsurers. We are working hard to forge a consensus on this issue, but Congress should monitor the FIO closely to ensure that it does not inappropriately seek to preempt such a consensus via the use of its preemption powers.

Consumer Financial Protection Bureau (CFPB). Unlike in the systemic risk world, DFA did recognize that consumer protection for insurance policyholders is already effectively handled at the state level. Thus, in establishing the new Consumer Financial Protection Bureau, Congress included a strong exemption protecting state regulatory authority and preventing the CFPB from regulating insurance. Insurers are nevertheless concerned that those who run the CFPB will seek to find "back door" ways to regulate insurance, for example, by seeking to regulate the circumstances under which lenders may purchase "creditor-placed" coverage for their borrowers who fail to demonstrate that they have obtained the required coverage on their property.

Explosion of Other Federal Regulation – In Addition to DFA Rules

Health Impact. While the Patient Protection and Affordable Care Act (PPACA) affected health insurers primarily, it had significant impacts on property casualty insurers as well. Perhaps most alarming to property casualty insurers is the precedent PPACA sets for federal involvement in insurance rate regulation. State regulators have wisely been moving away from stringent rate regulation in commercial lines (though not personal lines), and the prospect of uninformed federal intrusion is of extreme concern.

The PPACA also: (1) created retroactive liability under the Black Lung Benefits Act for certain claims that had been made not compensable in 1981 and for which insurers had received no premium; (2) required the Secretary of Health and Human Services (HHS) to recommend whether workers compensation insurers and automobile insurers should be brought within the HIPAA administrative simplification requirements, which are geared towards health insurance transactions, not property casualty medical transactions (potentially without adequate recognition of the differences); and (3) would have added significant accounting and paperwork costs for property casualty insurers under the now repealed expansion of IRS Form 1099 reporting.

Medicare Secondary Payer. Section 111 of the Medicare, Medicaid, and SCHIP Extension Act of 2007 requires insurers to determine whether claimants under property casualty policies are enrolled in Medicare. If they are, insurers must report over 200 data elements, many of which insurers had never collected. Insurers are expected to base their determination of Medicare status from information provided by claimants. However, claimants are often unwilling to cooperate and Congress did not provide insurers any tools to compel cooperation. There are equally significant burdens placed on insurers by the Centers for Medicare and Medicaid Services (CMS) in efforts to recover amounts claimed to be owed to Medicare. Rules imposed on insurers often: (1) are based on a lack of understanding of property casualty coverages and claim processes; (2) impose requirements that increase costs but not Medicare's MSP recoveries; and (3) fail to provide insurers with adequate and timely information needed to determine amounts to be reimbursed to Medicare.

International Regulation

The financial services industry is becoming more global in nature, and the insurance sector of that industry is no exception. Thus, regulators around the world are properly engaged in discussions on how to foster needed cooperation between regulators of financial firms that do business internationally, including insurance regulators. While international regulatory cooperation is a legitimate and worthy goal, insurers are concerned that these discussions appear to be moving beyond cooperation and toward developing mechanisms for international cooperation and toward the development of international regulatory and enforcement mechanisms where they are not appropriate.

Global Systemic Risk Regulation. For example, the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS) continue to try to develop a system for determining whether international insurance groups should be subject to additional regulation as "global systemically important financial institutions" or "G-SIFIs." However, in significant ways, their work appears to be largely uncoordinated with the US Financial Stability Oversight Council's systemic risk deliberations. Indeed, a recent FSB paper[2] sets expected deadlines for national regulatory authorities to take certain actions with regard to resolution and recovery plans for G-SIFIs, beginning with year-end 2011. The paper comments summarily that their recommendations' "effective implementation would entail changes in laws and regulation, supervisory practice and cross-border cooperation as well as within firms."[3] This ignores the fact that final US financial firm resolution rules are unlikely to be in place by that time.

The International Association of Insurance Supervisors (IAIS) is made up of insurance regulators from around the world. It seeks to coordinate insurance regulation for insurers doing business globally. The NAIC participates in the IAIS, but again the IAIS is not directly accountable to the US and its decisions can have an adverse effect on insurance regulation in the US.

European Solvency Regulation. The European Union is in the process of developing a revised solvency regulation system, known as Solvency II. That new system does not go into effect until 2013. Nevertheless, portions of the Solvency II insurance regulatory system have already been incorporated in new and binding IAIS Insurance Core Principles (ICPs) and standards that will be the basis of the next US Financial Stability Assessment Program (FSAP) review by the International Monetary Fund and the World Bank. The current version of the IAIS' project to

[2] "Effective Resolution of Systemically Important Financial Institutions – Recommendations and Timelines", July 19, 2011, pp. 18-19.
[3] Effective Resolution, supra, p. 8.

develop a "common framework for the supervision of internationally-active insurance groups" (ComFrame) proposes that all IAIS member jurisdictions (which include the NAIC and will include the FIO) be required to implement ComFrame when it is fully developed. In addition, the development of international accounting standards for insurers will almost certainly affect US GAAP and regulatory accounting systems for insurers. Although the NAIC is seeking to respond to these international developments by working on modernization of US solvency regulation, the NAIC is under pressure to comply with the prematurely enacted ICPs.

General Concerns. Some of the recent international developments represent improvements in international regulation. Insurers strongly support better coordinated oversight of holding company risk management, and we see significant promise in the ComFrame project to improve cooperation between regulators and increase the efficiency of group supervision, if it is properly limited. Similarly insurers are working with the NAIC in its solvency modernization process to make state regulation more efficient and effective. Nevertheless, insurers are quite concerned that international non-governmental bodies without legislative accountability and transparency are moving from developing best practices to attempting to impose binding standards. This poses the risk that European Union systems will be applied to US insurers when those systems have been developed for different markets and corporate structures that are less conducive to economic growth than the US structure. Such systems also fail to recognize that the US system is partially regulated through general corporate law and an expensive tort system. The conflict could result in the addition of new layers of duplicative and inefficient regulation for US insurers atop the currently effective, but expensive US model.

Future of Insurance Regulation

In the near term, US insurers will be dealing on multiple regulatory fronts to an extent they have never known. In addition to traditional state regulation, insurers will be buffeted by new regulations from various federal agencies and from international regulatory bodies. We see international insurance regulation converging toward global standards to some degree, but certainly not completely. There will be continuing (and perhaps greater) pressure on US regulators to become more Euro-centric and more highly-influenced by banking regulators, which can lead to complex, costly, burdensome new regulations that are duplicative of state regulation and inappropriate to the industry. While many of these regulations may be well intended, the "law of unintended consequences" threatens to create increased competitive imbalances and resulting harm to the US insurance marketplace.

These threats make it more important than ever that the bodies responsible for US insurance regulation and its oversight keep their heads and focus on the actions necessary to properly regulate the US marketplace. The U.S insurance regulatory system scored very well in a recent review by the International Monetary Fund, and we have no reason to believe that will not continue even as the US is pressured to harmonize insurance regulations with new international standards. Some of the standards, however, are simply inappropriate for the US market, and we have encouraged the NAIC that, while international convergence is important, making the proper decisions for US regulation is paramount. We are encouraged that senior regulators and NAIC leadership appear to agree.

Upcoming Congressional Issues

There are a number of issues that impact property casualty insurers that Congress is addressing or will address in the near future.

National Flood Insurance Program (NFIP). The National Flood Insurance Program will end on September 30, 2011, without further Congressional action. The House has passed legislation (H.R. 1309) and the Senate Banking Committee is scheduled to "mark-up" legislation next week. However, that leaves very few days on the Congressional calendar to get this legislation consolidated and enacted before the September 30 deadline. As the program lapsed four times in 2010, and has been the subject of ten short-term reauthorizations, it is now time to extend this program for at least five years and make other needed reforms to ensure that the 5.6 million property owners that rely on this vital program can continue to do so. Each program lapse causes significant disruptions in the vulnerable housing markets at a time when the US economy, and particularly the housing sector, is struggling to recover from the recent financial crisis.

Terrorism Risk Insurance Act (TRIA). The Terrorism Risk Insurance Act is a critical backstop to the private insurance market, due to the potential for a single terror incident to exceed the capacity of the property casualty insurance industry in the US. TRIA regulations have thus far maximized use of existing and effective state insurance regulatory tools, while minimizing federal intrusion. It will be critical for this approach to continue when Congress takes up renewal of TRIA in 2014.

DFA Oversight. Given the sheer number of rules various federal agencies will promulgate pursuant to DFA, the oversight role of Congress has never been more important. DFA left much to the discretion of regulators. While some will exercise that discretion responsibly, others may be tempted to assume regulatory powers that Congress did not intend, particularly with respect to insurers. We urge Congress to be aggressive in its oversight responsibilities and to hold frequent oversight hearings to help ensure that federal regulators focus on DFA's primary objective, i.e., to identify and ameliorate systemic risk, and not on extraneous matters that produce burdensome regulation with no economic benefit.

DFA also requires that numerous studies be completed, the first of which is an annual report due this fall from the FIO on the state of the insurance market. Studies are also being conducted on surplus lines standardization, reinsurance, reports on underserved segments of American consumers, as well as a host of other issues.

What Congress Should Consider Prioritizing

We strongly urge the Financial Services Committee to be aggressive in exercising its oversight authority over the myriad federal regulations now being drafted and promulgated to implement the Dodd-Frank Act, and to monitor closely international developments that may have negative impacts on US regulation. As you do, we urge you to keep the following principles firmly in mind:

- The US property casualty insurance industry is a strong job creator, which performed well during the recent financial crisis and has generally been well-served by state insurance regulators.
- Congress should exercise its oversight powers to ensure that federal regulators implementing the Dodd-Frank Act refrain from intruding inappropriately on state insurance regulation, and especially from imposing bank-centric regulations on insurers.
- International regulatory developments pose a threat not only to the US insurance industry, but also to the authority of both state and federal regulators. Congress should pay careful attention to these issues, and be prepared to exert influence as appropriate to prevent inappropriate international incursions into the jurisdiction of US regulators.

- Congress should pass legislation reauthorizing the National Flood Insurance Program (NFIP) for at least five years, and should include reforms to that program along the lines of those included in the House-passed H.R. 1309.

Thank you again, Chairman Biggert, for inviting me to share my thoughts and concerns with you today. I would be pleased to answer any questions you and other members of the Subcommittee may have.

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TESTIMONY FOR THE RECORD OF THE NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS LINES OFFICES BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY HEARING ENTITLED, "INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR CONSUMERS, BUSINESSES AND JOBS."

July 28, 2011

The National Association of Professional Surplus Lines Offices (NAPSLO) is pleased to submit the following testimony to the House Financial Services Committee, Subcommittee on Insurance, Housing and Community Opportunity regarding the impact of the surplus lines insurance reforms in the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

NAPSLO is a national trade association representing the surplus lines industry and the wholesale insurance marketing system. NAPSLO is the only association to represent both surplus line companies and brokers. Founded in 1974, NAPSLO has concentrated on being a trusted voice on surplus lines issues in all fifty (50) states, as well as in Washington, DC. NAPSLO is a valuable source of information regarding the vital role surplus lines plays in the insurance industry. NAPSLO has over 750 members representing 1,600 offices representing approximately 15,000 – 20,000 individual brokers, agents, company professionals, underwriters and other insurance professionals in 48 states and the District of Columbia.

The surplus lines reforms of the *Nonadmitted and Reinsurance Reform Act* ("NRRA") that passed as Title V, Part I of the *Dodd-Frank Act* were broadly supported, much needed, and intended to significantly simplify the nonadmitted insurance market. Unfortunately, as explained below, certain state interpretation and implementation of the NRRA has, in NAPSLO's view, been inconsistent with Congress's intent. NAPSLO's testimony will provide:

- background on the surplus lines industry and why the NRRA reforms were needed,

- a summary of the status of state implementation activities,
- an explanation on why NAPSLO has serious concerns about the NAIC's proposed tax sharing scheme, called "NIMA," and
- support for a formula that would improve state NRRA implementation for the benefit of all stakeholders.

Background on Surplus Lines Insurance Industry

Surplus lines is property and casualty insurance that covers unique, unusual, hard-to-place or non-standard risks for which insurance is not typically offered by insurers operating in the licensed or "admitted" or standard marketplace. Often referred to as "non-admitted" insurance, surplus lines covers risks that state-licensed or "admitted" companies are unable to or will not insure or do not meet the insurance requirements of the buyer.

The need for an insurance buyer to access the surplus lines insurance market can stem from an inability of standard or admitted companies to effectively evaluate a particular risk because of the risk's unique, novel or difficult underwriting characteristics or because of the lack of sufficient statistical information about the risk or that class of risk that would allow standard company underwriters to sufficiently analyze it. Some unusual risks include kidnappings, ransoms, business interruptions, environmental impairment, special events, amusement rides, and coastal properties, as well as general, professional and business liability coverage for those risks with unique, difficult or "challenging" underwriting characteristics. The need for surplus lines treatment may also evolve from the fact that a buyer may desire a level or limits of coverage on a risk that exceed that which standard or admitted companies are willing or able to offer. Thirty-three billion dollars in annual premiums were written in 2009 by surplus lines carriers. This figure represents over 13% of the total annual amount of commercial property/casualty insurance premium.

Why Title V, Part I of the *Dodd-Frank Act* ("NRRA") was Needed

For years the surplus lines insurance community – regulators and industry alike – recognized the need to streamline the regulation of the surplus lines industry and modernize surplus lines tax reporting and allocation procedures. During this time, NAPSLO was an active advocate in support of Title V, Part I of the *Dodd-Frank Act*, the *Nonadmitted and Reinsurance*

Reform Act (NRRA), as the way to fix the complex and often conflicting patchwork of state surplus lines laws and procedures that burdened brokers and companies.

The NRRA was passed to address the inconsistent way in which states manage their premium tax allocation and remittance schedules. The proper allocation and remittance of surplus lines premium taxes to the states on multi-state risks had been a growing problem for over a century. The passage of the Gramm-Leach-Bliley Act (GLBA) in 1999 added to the severity of this burden by increasing the number of non-resident surplus lines broker licenses. GLBA "compelled" states to grant reciprocal licenses through a threat of preemption, and, as more surplus lines brokers obtained nonresident surplus lines licenses, they quickly discovered that state laws fail to provide guidance on which state surplus lines law governs a multi-state surplus transaction.

The failure of the states to establish a uniform and consistent method of remitting surplus lines premium taxes on multi-state surplus lines risks brought forth confusion and complexity in the market from the standpoint of the consumers as well as the producers. For almost two decades, the National Association of Insurance Commissioners (NAIC) tried, unsuccessfully, to solve the problem through initiatives to harmonize the inconsistencies. Over time, however, the severity of this problem increased, since more and more surplus lines placements have become multi-state risks. The genesis of this problem lies in the contradictory and inconsistent state regulatory and tax laws, which make multi-state surplus lines transactions complicated, confusing, and very costly to all parties.

The NRRA sought to remedy two primary types of inconsistencies and conflicts in state laws. First, there was no universally accepted allocation formula among states: meaning the broker had to determine which state's allocation formula governed the multi-state transaction and, when the state laws conflicted, the broker had to try to use some rational basis for allocating taxes to each state.

The second regulatory breakdown involved licensing standards. Prior to the NRRA, there were true safeguards to prevent licensing discrimination against nonresident agents and brokers, and the lack of clarity created a varying regulatory climate which changes, for better or for worse, according to the jurisdiction in which you operate. The NRRA addressed this problem by adopting uniform standards for producer licenses. It also mandates that no jurisdiction other than an insurer's home state may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate non-admitted insurance. The NRRA also contemplates a national producer database which will assist with the proper collection of licensing fees for non-admitted brokers. Multiple compliance requirements for surplus lines brokers is fraught with bureaucratic red tape, and NAPSLO has long been a proponent of reciprocal participation across jurisdictions.

To illustrate the point, consider a broker who has exposures in five (5) different states; does this constitute the application of five (5) separate state laws and five (5) different tax filings? Does this require five (5) diligent searches and five (5) different license requirements? Now imagine how this problem would translate nationwide with an exposure in fifty (50) states. This is nothing short of a recipe for disaster, and further demonstrates the regulatory problems that the NRRA intended to resolve.

As envisioned by Congress and supported by all stakeholders, the NRRA would both streamline tax payment processes and to make more uniform, simple, and efficient licensing standards and other aspects of surplus lines regulation to enable brokers to more easily and efficiently comply with state requirements. As expressed by one of the bill's primary sponsors, Congressman Dennis Moore:

"The goal of the NRRA was not to eliminate regulatory protections, but to streamline the regulatory regime to enable insurers and brokers to more easily and efficiently comply with state rules and provide much-needed insurance protections to consumers. The law accomplishes this by giving sole regulatory authority over a surplus lines transaction—including the authority to collect premium taxes—to the home state of the insured."

Since passage of the *Dodd-Frank Act*, states and stakeholders have been working with varying levels of success on implementation of the NRRA in anticipation of the July 21, 2011 effective date.

State Implementation

Immediately after the passage of the *Dodd-Frank Act*, NAPSLO offered to help the NAIC, state policymakers and regulators, insurance brokers and companies with NRRA implementation and ongoing compliance. For example:

- In early 2011 NAPSLO, along with the American Association of Managing General Agents (AAMGA) and the Council of Insurance Agents & Brokers (CIAB), provided clear recommendations to state legislators and insurance commissioners on the mandatory provisions of the NRRA.
- At the same time, NAPSLO also provided draft NRRA implementing legislation to all states, began meeting with state legislators and insurance commissioners in almost every state, provided testimony at state hearings, and drafted amendments to legislation – all in an effort to increase the likelihood that each state's implementing legislation would be consistent with Congress's intent for the NRRA.

To date, 43 states have passed some sort of NRRA implementing legislation, and:

- 3 states – Iowa, Illinois, and Colorado – adjourned without taking action;
- 4 states – Michigan, Wisconsin, Massachusetts, and South Carolina, and the District of Columbia – have not yet passed any legislation, and
- 3 states have approved legislation that is awaiting action by the Governor – Delaware, Oregon and New Jersey.

A handful of the 43 states that have take action, as well as the NAIC, have offered guidance and/or bulletins to brokers regarding the new "home state" rules for multi-state risks and other aspects of NRRA compliance. NAPSLO appreciates the leadership these entities have demonstrated, and urges all states to issue the NAIC Model Bulletin.

Despite the appropriate and much needed guidance issued by a handful of entities, NAPSLO is increasingly concerned that the NRRA is being implemented in many states (even as promoted by NAIC) in such a way that they'll make things worse – not better – for surplus lines stakeholders. As explained, the NRRA and its legislative history provide that the law was intended to both streamline tax payment processes for brokers and to make more uniform, simple, and efficient other aspects of surplus lines regulation. Thus, by giving the "home state" the sole authority to regulate the surplus lines broker, the NRRA would enable brokers to more easily and efficiently comply with state requirements. Unfortunately, most states are focusing their attention on the tax payment and allocation issues, while neglecting the law's other goal – to make more uniform, simple, and efficient other aspects of surplus lines regulation.

Improper Emphasis on Tax Sharing

There are two competing approaches for sharing multi-state surplus lines taxes:

1) Surplus Lines Insurance Multistate Compliance Compact ("SLIMPACT-Lite") which has been passed by nine (9) states and is supported by National Conference of Insurance Legislators (NCOIL), the Council of State Government (CSG), National Conference of State Legislators (NCSL) and industry stakeholders, and
2) The Nonadmitted Insurance Multistate Agreement ("NIMA") proposed by the NAIC.

Attached as Exhibit 1 is a side-by-side comparison of SLIMPACT-Lite and NIMA.

While there remain numerous uncertainties over how the NIMA system would work, NAPSLO believes that the underlying proposal does not fulfill the intent of Congress to establish an efficient and uniform landscape for the industry. NAPSLO is not alone in this view; surplus lines attorney Rick Brown also finds fault with the NIMA approach; attached as Exhibit 2 is his paper "An Analysis of the Nonadmitted Insurance Multi-state Agreement."

Simply put, NIMA states and the NAIC seem to be putting the prospect of money in the form of premium tax revenues before the letter and spirit of the surplus lines reforms passed in the *Dodd-Frank Act*. Specifically, to date, twelve (12) states have legislatively approved joining the NAIC's tax-sharing agreement, called the Nonadmitted Insurance Multistate Agreement ("NIMA"), and a number of states have already signed an agreement to be part of this system. These states are prioritizing the voluntary tax-sharing provisions in the NRRA while ignoring the other regulatory efficiencies intended by the law. Moreover, states are spending time and energy focusing on NIMA even while the NIMA system remains months away from being operational. A vendor has yet to be selected to manage the central clearinghouse, though we've heard that the NAIC itself has proposed to operate NIMA -- so that, for a fee, the NAIC would collect and allocate multi-state taxes.

Problems with the NIMA Tax Allocation Methodology

NAPSLO and other industry stakeholders have consistently opposed the NIMA tax sharing system because, as currently drafted, it:

- Fails to create the non-tax regulatory efficiencies or uniformities envisioned by Congress;
- Violates the NRRA requirement that "no state other than the home state . . . may require any premium tax payments for nonadmitted insurance," and;
- Involves unnecessary and burdensome data reporting by brokers for the sole purpose of collecting taxes, including novel allocation requirements for casualty lines.

Specifically, NAPSLO strongly opposes NIMA's current tax allocation methodology as it is wholly unworkable for the vast majority of the industry, and if implemented will result in new costs and fees levied on surplus lines consumers. Attached as Exhibit 3 is document detailing the real-life problems surplus lines brokers have with the proposed NIMA tax allocation methodology.

To be consistent with the new federal law, NAPSLO believes that if states are going to share surplus lines premium taxes – something not required by the NRRA, the tax sharing methodology must be designed so that it:

- relies on existing data, rather than requiring the creation of new categories of information,
- is consistent with current industry practice, and
- respects the home-state rule that was established under the NRRA.

NAPSLO's Efforts to Improve the NIMA Tax Allocation Methodology

For almost a year NAPSLO has been trying to work with the NAIC, the Surplus Lines Task Force, and NIMA state leaders to fix the NIMA tax methodology to the benefit of all stakeholders, yet our pleas have fallen on deaf ears. What is more, we've recently heard from the NAIC and NIMA leaders that NAPSLO is "too late" in proposing alternatives to the NIMA allocation methodology, and that we should have spoken up sooner. To debunk this myth, is a detailed timeline showing NAPSLO's efforts to fix the NIMA allocation methodology. This timeline shows that NAPSLO has been clear and consistent from the moment this allocation approach was introduced that it is not workable and must be changed. In short, for six months industry representatives were ignored, and then for the last two months NAPSLO have been given lip service without any action.

Timeline of NAPSLO Activity

- SLIMA Proposed and Adopted: October 2010. Florida proposed SLIMA, which ultimately was renamed NIMA. It is subsequently adopted a few days after its proposal. It contained the following language with respect to allocation.

  For purposes of determining how the premium charged for a specific risk will be allocated by the broker among the Participating States, the tax payable to each state shall be computed on the portion of premium attributable to the exposure located in each state based on the rating basis used to determine the premium for the particular policy.

  In the event that the use of the rating basis is not practical, another equitable apportionment may be used provided it is adequately described on the allocation worksheet. Brokers must consistently apply the formula or methodology utilized across similar types of insurance policies and must maintain for a period of five years the worksheet used to determine the premium allocation

- NIMA Allocation Formula Proposed: November – December 2010. Alaska Insurance Commissioner Hall was assigned the task of offering an initial allocation proposal, which she presented at the NAIC Surplus Lines Task Force Meeting in November. This was the first unveiling of the tax allocation proposal that evolved in to what has been attached to NIMA ever since. At the meeting, the industry had its first opportunity to discuss allocation with Task Force leaders. NAPSLO Legislative Co-Chair and Executive Vice President and Director of The Sullivan Group, Hank Haldeman spoke frankly about the problems of the proposed NIMA allocation formula, and explained that it contained many unworkable allocation bases. The NAIC offered no immediate response but noted that the problems Haldeman raised would be taken under consideration and that the proposal was not final. In December, a detailed version of the allocation method was attached to the NIMA draft. NAPSLO's submitted written comments were not discussed at the December 1st teleconference.

- December 3, 2010 Brokers Letter

  Because there was no discussion of allocation during the December 1st meeting, some brokers submitted a letter to Commissioner Donelon and the NAIC Surplus Lines Task Force on December 3rd, clearly explained the problems the NIMA formula would create for insureds as well as brokers, and requested that the Surplus Lines Task Force develop an allocation approach "in active discussion with the brokers that handle the specific types of coverage involved."

- December 10, 2010 Task Force Meeting

  This was, essentially, the final organizing/drafting meeting for NIMA. The Brokers Letter was attached to the meeting materials, and NAPSLO was given an opportunity to comment. NAPSLO member brokers emphasized the industry concerns with the NIMA formula again. At that meeting, and consistently from that point forward, NAPSLO has stated the proposed NIMA allocation approach is unworkable and inconsistent with the intent of the federal surplus lines reforms. No further discussion, or opportunity to discuss, took place until the March 2011 meetings.

- March 2011 NAIC Meetings

  At the Spring Meeting of the NAIC in early March NAPSLO and other industry stakeholders renewed their stance on the allocation scheme. Though there appeared to be some direction towards revising the allocation methodology, no action followed.

- Broker Reaction Document to NIMA Allocation – early April, 2011

  In early April, NAPSLO released the short survey of broker feedback on the NIMA allocation approach, detailing myriad issues. This document is attached as Exhibit 3. This document was provided to the NAIC Surplus Lines Task Force members, state legislatures considering NIMA, and to other stakeholders.

  In early April, NAIC Surplus Lines Task Force representatives assured industry representatives that the Task Force would consider some modification to the NIMA tax allocation methodology. In late April, Task Force representatives suggested that it was "too late" to consider modifications to the NIMA methodology.

  Things again went silent until NAPSLO requested a meeting in Washington, D.C. with NAIC staff.

- NAPSLO Meeting with NAIC Staff – May 12, 2011

  NAPSLO met with NAIC staff to again articulate industry's concerns with the NIMA methodology. NAIC staff was receptive, and seemed willing to consider the request for a formal opportunity, (e.g. a task force or committee or advisory group) to bring NIMA proponents and industry together to fix the allocation methodology. During this meeting, NAPSLO also offered two potential approaches as the basis for discussion.

  From May through June, NAPSLO had various conversations with NAIC staff and Commissioner Donelon and there appeared to be a commitment to address allocation, but never any action.

- NAPSLO Call with Commissioner Donelon – July 11, 2011

  During this short call, a NAPSLO member and representatives spoke with Commissioner Donelon and NAIC staff about the proposed Schedule T allocation approach. Commissioner Donelon indicated a willingness to consider changes to the NIMA methodology, but questioned whether such would be possible without legislative changes to NIMA state statutes. Later Commissioner Donelon suggested an alternative exposure-based approach, like Kentucky's proposal, would be more likely to be successful with NIMA states. NAPSLO has since agreed to compromise and support the Kentucky approach, even though the Schedule T approach is still preferred. NAPSLO has communicated our position to the NAIC and certain NIMA states; we await some action.

This recitation of facts is intended to explain NAPSLO's frustration with the NAIC and NIMA' states, who refuse to seriously consider any proposal to amend the convoluted and unworkable NIMA tax allocation system. In our view, their actions betray Congress's efforts to streamline the surplus lines regulatory system. We applaud this Committee's work in passing the *Nonadmitted and Reinsurance Reform Act* as part of the *Dodd-Frank Act*, and hope that the NAIC and NIMA states will soon show some respect of Congress' intentions by taking action to amend their tax allocation methodology.

Opportunity for Improvement

NAPSLO continues to urge the NAIC to amend NIMA's tax allocation methodology to provide a simple, efficient, and equitable means of tax allocation. While we favor using market-share as the basis for tax allocation, NAPSLO has been impressed by the work of Kentucky's Insurance Commissioner, Sharon Clark, and her formula to allocate taxes based exposures. In our view, Kentucky's tax allocation formula presents a workable compromise that would be a vast improvement over the NAIC-NIMA tax methodology currently envisioned. NAPSLO strongly urges all parties to abandon the NIMA tax allocation methodology and instead adopt a formula like the "Schedule T" methodology or Kentucky's exposure-based approach.

It may be that Kentucky's proposal is the most viable option to immediately remedy the most onerous aspect of the NAIC-NIMA approach. While we have heard that some NAIC and NIMA state leaders are amenable to the Kentucky approach, to date we have seen no tangible action from them to advance this option. Indeed, just the opposite is occurring -- certain NIMA states have already moved ahead with NIMA using the original burdensome, complex exposure-based methodology.

Conclusion

In conclusion, NAPSLO hopes today's hearing will

- shed further light on the problems of NIMA – especially its current tax allocation methodology;
- remind the NAIC and NIMA state leaders about the NRRA's purpose which was to create a more simple, efficient and uniform system of surplus lines regulation for the benefit of all stakeholders; and
- inspire the NAIC and NIMA state leaders to abandon their currently convoluted and burdensome tax allocation methodology, and replace it with Kentucky is reasonable, workable compromise approach, or a "Schedule T" like methodology.

Again, I thank the Committee, its leadership and staff for the opportunity to testify at this important hearing.

Exhibit 1

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Differentiating characteristics of SLIMPACT-Lite and NIMA

Overview

Congress passed the *Nonadmitted and Reinsurance Reform Act* (NRRA) as part of the *Wall Street Reform and Consumer Protection Act* which was signed into law on July 21, 2010.

The NRRA seeks to, "streamline the regulatory regime to enable insurers and brokers to more easily and efficiently comply with state rules and provide much-needed insurance protection to consumers." - *The Honorable Dennis Moore (D-KS), Primary sponsor of NRRA, December 15, 2010 – Federal Register.*

In the wake of NRRA's passage, two approaches for implementing the NRRA have prevailed at the state level – Surplus Lines Insurance Multistate Compliance Compact ("SLIMPACT-Lite") and the Nonadmitted Insurance Multistate Agreement ("NIMA"). The following is a brief overview of the two competing approaches.

Side-by-Side Comparison

Provision	SLIMPACT-Lite	NIMA
Origins	Drafted by over 60 industry representatives, brokers and trade associations with input from regulators and legislators.	Drafting began in the Fall of 2010 by an NAIC working group of 12, comprised mostly of state insurance department staff.
Scope	Drafted to create an efficient tax allocation system for brokers **and** to develop uniform standards to modernize and streamline state-by-state standards and processes.	Addresses tax treatment only. Does not attempt to address the NRRA's call for a more uniform standards and processes.
Design Structure	An interstate compact which provides legal means for states to jointly regulate in a uniform manner. Compacts were expressly referenced in NRRA.	A proposed contract, not a compact. It is intended that state legislatures will authorize states to enter the agreement with other states or a clearinghouse that has yet to be created.
Governing Structure	Includes a Commission whose members are chosen by the States, an Executive Committee as a governing board, and an Operations Committee. The structure is patterned after the IIPRC.	Includes no consideration of a governing structure.

Tax Collection	Each state must limit tax collection to *no more than* four specific dates a year with the option of annual, semiannual or quarterly collection.	Requires all states to convert to quarterly tax returns.
Tax Rate	Each state is permitted to establish one single rate of taxation to apply to nonadmitted insurance transactions.	Similar to SLIMPACT-Lite but subject to change.
Tax Allocation Methodology	Not yet finalized, but the SLIMPACT guiding principles note that, *"allocation formulas will be established with input from Surplus lines Licensees and be based upon* <u>*readily available data*</u> *with* <u>*simplicity*</u> *and* <u>*uniformity*</u> *for the Surplus Line Licensee as a material consideration."*	Current version is highly complex, burdensome, and unworkable for the industry as it involves dozens of different allocation formulas and requires a minimum of between 30 and 80 data elements per policy, for both property and casualty lines.
Solvency & Eligibility	Includes authority to set national insurer solvency/eligibility standards. NRRA prohibits most state-specific eligibility standards but authorizes the adoption of national uniform eligibility standards through a compact or similar mechanism.	No similar provisions. As a result, states may have limited authority to impose solvency oversight on insurers writing surplus lines business.
Establishment of Clearinghouse	10 states of states must enact the compact before it can create a clearinghouse and adopt uniform rules.	2 states can agree by contract and establish the clearinghouse and plan of operations.
Industry Endorsements	Endorsed by NAPSLO, AAMGA, CIAB, RIMS, PCI, NCOIL, NCSL, CSG, numerous state stamping offices and other insurance trade associations.	Adopted by the NAIC and is largely opposed by industry.

Conclusion

NIMA is inconsistent with the NRRA and therefore should not be adopted by states.

1. NIMA fails to implement the efficient system or uniformity required by the NRRA.
2. NIMA violates the NRRA requirement that "no state other than the home state . . . may require any premium tax payments for nonadmitted insurance."
3. NIMA involves unnecessary and burdensome data reporting by brokers for the sole purpose of collecting taxes, including novel allocation requirements for casualty lines.

Exhibit 2

RICHARD A. BROWN
ATTORNEY-AT-LAW

ANALYSIS OF THE NONADMITTED INSURANCE MULTI-STATE AGREEMENT (NIMA)[1]

May 11, 2011

The National Association of Insurance Commissioners (NAIC) has proposed that the States enter into a multi-party contract – The Nonadmitted Insurance Multi-State Agreement (NIMA) – pursuant to Section 521(b)(1) of the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA). The NAIC has also has released a draft "Nonadmitted Insurance Premium Tax Clearinghouse Access Agreement" ("Clearinghouse Contract") between the "Clearinghouse" and Participating States[2].

The purpose of the NRRA is to simplify and streamline regulation and taxation of surplus lines insurance transactions. Effective July 21, 2011, the NRRA establishes Home State taxation whereby each surplus lines transaction may be taxed and regulated only by the "Home State." Section 521(a). The NRRA preempts state law to eliminate the multistate taxation and regulatory system that has subjected surplus lines brokers to costly and burdensome compliance with conflicting state taxation and regulatory filing requirements for policies that insure risks in more than one state.

The purpose of NIMA, in contrast, is to replicate and preserve via a "Clearinghouse" substantially the same system of multistate taxation that Congress sought to eliminate through creation of Home State taxation under the NRRA.

This paper reviews certain major issues presented by NIMA and the Clearinghouse Contract.[3]

A. Overview

- The NIMA Clearinghouse venture is inherently unstable.

  In any year some Participating States will be Clearinghouse winners and other States will be Clearinghouse losers. The losers will quickly give sixty days notice of termination and exit NIMA. Larger surplus lines states that believe they will benefit from Home State taxation will not join.

- NIMA is incomplete, its terms vague, and its enforceability highly doubtful. The data do not exist that would allow comparison of the premium tax revenue consequences of NIMA and the Clearinghouse with (a) historical premium tax revenues or (b) the effects of

[1] This paper has been commissioned by the National Association of Professional Surplus Lines Offices (NAPSLO). The author is a recognized expert on the NRRA who has written multiple articles about the NRRA and related state implementing legislation. Copies of those articles can be found at www.InsuRegulatory.com and www.InsuranceJournal.com.

[2] Unless otherwise noted, section references are to the NRRA; paragraph references are to NIMA or the Clearinghouse Contract as the context indicates.

[3] NIMA's "Exposure Allocation Methodology" and specific data reporting requirements are beyond the scope of this paper.

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Home State taxation. NIMA's dispute resolution provisions lack standards or criteria for measuring a Participating State's right to compensation in the event of a dispute.

- The Clearinghouse has no governance structure and the NAIC's role in Clearinghouse governance is undefined. There is no timeline for the Clearinghouse to become operational, no budget, and no financial projections.
- NIMA fundamentally conflicts with the NRRA.
- NIMA presents insurmountable compliance obstacles for surplus lines brokers. NIMA's membership and tax rates can change at any time with little or no notice. When that occurs, the surplus lines broker is forced to reprogram accounting and data processing systems to take account of extraordinary premium allocation and tax rate calculation complexities depending on (a) whether taxes are paid and filings made directly to the Home State or (b) to the Clearinghouse.
- The NAIC describes NIMA as a "multistate agreement," a legally untested approach to an interstate pact that does not satisfy the requirements of an "interstate compact" within the meaning of Article I, Section 10 of the United States Constitution.
- NIMA and its Clearinghouse are subject to inevitable challenge on numerous legal grounds that likely will engage Participating States in litigation for years.

B. NIMA Background

At the NAIC Summer Annual Meeting in August 2010, the NAIC Executive Committee charged a "Surplus Lines Implementation Task Force" with development of state-based solutions for implementation of the surplus lines provisions of the NRRA.

The Task Force determined that the best solution was to create an "interstate agreement" that provides "a means for preserving something close to the status quo where premium taxes are concerned."[4] The status quo is the multistate surplus lines taxation system that Congress enacted the NRRA to eliminate.

The Task Force appointed a subgroup to be responsible for developing a Clearinghouse plan of operation and for identifying third-party vendors with the software and other capabilities to operate the Clearinghouse.

NIMA itself consists of an eight page form of contract accompanied by eight pages of "Annexes" that specify how surplus lines premium is to be allocated for multistate risks. The NAIC is not a party to NIMA or the Clearinghouse Contract, or mentioned in either document.

When the NAIC Executive Committee "approved" NIMA in December 2010, NIMA was not in final form. The Executive Committee has not yet "approved" the Clearinghouse Contract. NIMA remains a working draft in the early stages that posits only a general framework for

4 NAIC Initiatives Non-Admitted and Reinsurance Reform Act of 2010 (NRRA): Surplus Lines (www.naic.org)

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establishing a Clearinghouse and procedures for receipt and redistribution of surplus lines tax among Participating States.

C. Inherent Instability

Each Participating State necessarily exposes its treasury to reduction by the amounts of Home State surplus lines tax revenues that the Clearinghouse may allocate to other Participating States. On sixty days notice a Participating State can terminate under NIMA to cut its losses or bank its winnings, as the case may be (¶ 26(a)).

NIMA's only requirement to rejoin the Clearinghouse is "renewed execution of the Agreement."

NIMA's sixty-day termination notice provision underscores the fact that states are unwilling to make a long-term commitment to NIMA and the Clearinghouse. Once a Participating State sees that it is sending premium tax revenues to other Participating States or that its Clearinghouse allocation is less than the premium taxes it would have received as the Home State, the Participating State will terminate. That cycle will naturally repeat itself until NIMA collapses.

Larger states like New York and California that are the principal place of business for many large national and multi-national businesses, and therefore expect to benefit from Home State taxation, have declined to participate in NIMA. After the NRRA takes effect on July 21, 2011, states have no apparent incentive to share their Home State tax revenues with sister states.

Under the pre-NRRA system, there have been no uniform rules for allocation of surplus lines premium tax. Surplus lines brokers therefore have allocated premium for multistate risks based largely on the broker's professional judgment and industry convention. Accordingly, there are no data showing the premium tax effects of any given allocation methodology. It therefore is impossible to determine how NIMA's premium allocation methodologies will affect the premium tax revenues of any Participating State.

Similarly, it will be some time before there are reliable data to compare whether a Participating State's share of Clearinghouse tax collections are greater or less, after consideration of Clearinghouse transactional costs, than what a Participating State would have received under Home State taxation. Until reliable Home State taxation data are available, it is impossible for a state to measure the effects of NIMA and the Clearinghouse on its surplus lines premium tax revenues.

NIMA's dispute resolution provisions provide no standards or criteria to measure damages for a breach of NIMA and require mediation before a Participating State may initiate arbitration or litigation. Resolution of disputes between and among Participating States, the Clearinghouse, and the NAIC will be protracted and necessarily disrupt receipt of tax revenues by Participating States for years. NIMA provides no alternative dispute resolution remedies for surplus lines brokers forced to use the Clearinghouse.

Legal challenges on numerous grounds will embroil Participating States, as well as the NAIC, in protracted litigation that also can be expected to disrupt Participating States' receipt of tax revenues for years.

D. Uncertain Governance

NIMA's governance provisions are Spartan.

NIMA becomes effective upon execution by two or more Participating States, two-thirds may amend it in writing (¶ 25), and the Clearinghouse will operate "pursuant to a plan of operation, to be agreed by two-thirds of the Participating States" (¶ 10). As a practical matter, once a plan of operation is approved by the first two Participating States, the two-thirds amendment requirement will make it difficult if not impossible for subsequent Participating States to modify NIMA.

NIMA provides that "each Participating State agrees to require, by statute or rule" that surplus lines brokers remit surplus lines premium taxes to the Clearinghouse (¶ 17). NIMA therefore would bypass state legislative and administrative rulemaking requirements concerning matters such as the Clearinghouse's authority to demand data and to conduct premium audits.

The Clearinghouse Contract provides: "The State is represented by the state agency or agencies charged with enforcing State laws and regulations relating to Nonadmitted Insurance premium taxes." (Recitals, ¶ B). Many states therefore would be represented by at least two agencies, the department of insurance and the state agency responsible for premium tax collection and enforcement.

NIMA and the Clearinghouse Contract are silent regarding whether the Clearinghouse will be a corporation, a partnership, or some other form of business or nonprofit enterprise.

NIMA and the Clearinghouse Contract offer no governance or advisory role for surplus lines brokers and other affected parties.

E. NRRA Conflicts

NIMA fundamentally conflicts with the NRRA.

First, NIMA conflicts with the NRRA's principal purpose, which is to simplify and streamline regulation and taxation of multistate surplus lines transactions.

Second, NIMA redefines certain NRRA's terms and adds terms that would restrict and undermine the NRRA.

1. Home State

Home State is generally defined by the NRRA to mean the state of the insured's "principal place of business" or "principal residence." The NRRA, however, does not define "principal place of business." Relying on a recent U.S. Supreme Court decision, Friend v. Hertz, __U.S. __, 130 S. Ct. 1181 (2010), a case involving the "diversity-of-citizenship" jurisdiction of the federal trial courts, NIMA defines "principal place of business" in a way that leaves the term Home State open to multiple interpretations certain to confuse both licensees and premium auditors.

To determine Home State under the NIMA principal place of business definition, the surplus lines broker is required to verify (a) where the insured maintains its headquarters, (b) where the insured's "high-level officers direct, control, and coordinate its business activities,"

(c) whether they do so in more than one state, and (d) whether the headquarters are located or the "high-level officers direct, control, and coordinate its business activities" outside any State."

"Principal place of business" is a legal term of art that has been the subject of hundreds of federal court decisions over the years. The easy cases obviously are not litigated. Those that are litigated are highly fact-sensitive. It is legal folly for NIMA to attempt a "one size fits all" definition of principal place of business, particularly in the untested arena of NRRA preemption.

2. Group Insurance

NIMA defines the Home State for "Group Insurance" to be each state where a group member pays any portion of the premium from his, her, or its own funds; in other words, multiple Home States. The NRRA provides that there shall a single Home State; the term Group Insurance does not appear in the NRRA.

The Group Insurance definition of Home State under NIMA directly conflicts with the NRRA and would eviscerate many group insurance programs by making them cost-prohibitive due to the transactional costs involved with multiple state tax and regulatory filing requirements.

3. Surplus Lines Insurer Eligibility

Although NIMA does not address surplus lines insurer eligibility directly, it does so indirectly:

> "Surplus Lines Insurer" means a Nonadmitted Insurer permitted ***under the law of the Home State*** to accept business from a Surplus Lines Licensee. [¶ 5.n.]

The NRRA preempts state law to set uniform national standards for surplus lines eligibility. Provided that the nonadmitted insurer satisfies Home State minimum capital and surplus requirements ***or*** is listed on the NAIC Quarterly Listing of Alien Insurers, a state ***may not prohibit*** a surplus lines broker from placing insurance with a nonadmitted insurer. Section 524.

F. Compliance Impossible

Each time a Participating State joins or exits NIMA, surplus line broker agent management and accounting systems must be reprogrammed with new premium tax rates and premium allocation formulas to comply with NIMA or the Home State's rules, as the case may be. Compliance and training procedures similarly must be updated.

- NIMA allows Participating States to exit on sixty days notice and re-join at any time simply by re-executing NIMA.
- Participating States must give ninety days notice of changes to their premium tax rates and statewide assessments. However, the effective date for the change need not coincide with a calendar quarter or any other normal accounting period.
- The surplus lines broker may be required in some cases to determine premium tax differently depending on whether premium allocations for non-Home State exposures involved Participating States.

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- NIMA and the Clearinghouse Contract require no notice to surplus line brokers about changes in NIMA membership or changes in Clearinghouse tax rates, fees, or procedures.

There are a virtually infinite number of programming variables associated with Participating States (a) exiting NIMA on sixty days notice to rejoin whenever they wish, and (b) ever-changing tax rates and statewide assessments with inconsistent effective dates. Simultaneous compliance with Home State law for non-NIMA states introduces yet another complex set of programming variables. Combined with the NIMA/Clearinghouse lack of notice requirements, compliance is impossible.

Many surplus lines brokers contract with one of several major data processing vendors for access to an "agency management system" that tracks policy information, premium allocations, and other transactional data. Major programming changes can require a consensus of representatives of perhaps hundreds of users. Once major programming changes are agreed, it can take months or longer for the programming to be completed, tested, and implemented.

NIMA and the Clearinghouse are the antithesis of the nationwide uniformity intended by Congress. Instead of simplicity, the NIMA/Clearinghouse venture would subject surplus lines brokers to compliance requirements considerably more complex, cumbersome, and costly than the multistate taxation system in effect prior to July 21, 2011.

G. Compact Considerations

NRRA Section 521 provides:

(a) Home State's Exclusive Authority. – No State other than the home State of an insured may require any premium tax payment for nonadmitted insurance.

(b) Allocation Of Nonadmitted Premium Taxes. –

(1) In General. – The States may enter into a compact or ***otherwise establish procedures*** to allocate among the States the ***premium taxes paid to an insured's home State*** described in subsection (a).

***

(4) Nationwide System. – The Congress intends that each State adopt ***nationwide uniform requirements,*** forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for Nonadmitted insurance ***consistent with this section.***

The NRRA provides that surplus lines brokers shall pay surplus lines premium tax only to the Home State. Congress leaves to the States how to allocate such premium tax receipts among themselves. There is no suggestion in the NRRA that two or more States may ***contract*** to require surplus lines brokers to remit surplus lines premium tax ***other than to the Home State.***

The co-author of a treatise on interstate compacts and leading authority on the topic has opined that NIMA does not satisfy the requirements for an interstate compact because it (a) "fails to provide a binding agreement which pre-empts other state laws n conflict with its requirements," and (b) "unconstitutionally purports to vest authority in an Executive Branch official (e.g., the Insurance Commissioner) to bind the Legislature of a State which adopts it."[5]

H. Legal Challenges

NIMA and the Clearinghouse Contract are subject to legal challenge on a number of grounds, including:

- NIMA fundamentally conflicts with the NRRA.
- NIMA is unenforceable due to omission of contract terms essential for a "meeting of the minds" among Participating States.
- The NAIC has failed to disclose material information such as financial projections, a plan of operation, and the NAIC's role with the Clearinghouse and its governance.
- NIMA requires unlawful delegation of legislative authority to one or more state agencies.
- NIMA and the Clearinghouse Contract fail to comply with state government contract requirements. They also would violate state administrative procedure act and "Sunshine" laws, thereby denying Due Process to surplus lines brokers, potential bidders seeking to provide Clearinghouse services, and other affected parties.
- NIMA is subject to potential antitrust scrutiny under Section 541[6] in connection with the NAIC and Task Force roles in establishing and controlling the Clearinghouse, and arguably otherwise attempting to restrain trade and commerce.

I. Conclusion

NIMA is incomplete and ill-conceived. The Clearinghouse is ill-defined and far from becoming operational.

NIMA is essentially a game of chance for Participating States where the losers will quickly leave the table, an inevitable recurring cycle.

Standing alone, the purported economic benefit from participation in the Clearinghouse is illusory. Absent reliable data, a Participating State cannot determine the comparative amounts of surplus lines premium tax revenues it would receive as Home State free and clear of Clearinghouse transaction costs, leaving aside exposure to unquantifiable potential liabilities.

NIMA and the Clearinghouse would impose intolerable compliance costs on surplus lines brokers and increase the cost of insurance with no benefit to surplus lines insurance buyers or measurable benefit to Participating States' treasuries.

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5 Letter from Rick Masters, Special Counsel for Interstate Compacts, to NCOIL, NCSL, and CSG (January 26, 2010). A copy can be found on the website of the Council of State Governments (www.csg.org).

6 "Nothing in this subtitle or the amendments made by this subtitle shall be construed to modify, impair, or supersede the application of the antitrust laws. Any implied or actual conflict between this subtitle and any amendments to this subtitle and the antitrust laws shall be resolved in favor of the operation of the antitrust laws."

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Home State taxation under the NRRA is a straightforward solution for the confusing and conflicting multistate surplus lines tax system that has burdened the surplus lines industry for decades. If and to the extent that Home State taxation should adversely affect premium tax revenues of certain states, the issue can be addressed directly with Congress or through an interstate compact.

NIMA with its inherent instability cannot solve the problem.

Exhibit 3

Surplus Line Broker Observations on the Implementation of NIMA's Allocation Methodology

April 10, 2011

The following is compiled only as a sampling of the kinds of problems and issues Surplus Line Brokers perceive in implementing the Allocation Methodology included in NIMA. It is not a comprehensive review and commentary on the allocation basis proposed for each coverage.

A copy of the Allocation Methodology included in NIMA was circulated to eleven wholesale Surplus Line Broker firms to comment generally on the feasibility of implementing the methodology. The following, immediate responses were received. All are direct quotes. Additional information on the process follows at the end.

Comments on Specific Allocation Proposals

The following comments were made by brokers actually handling the specific type of risk upon first review of the NIMA Allocation Methodology:

Directors & Officers Liability

Proposal: Allocate by "Revenue Generated" in each state

- "It [allocate premium by revenue generated in each state] would potentially be a challenge and problem for the insureds. First of all, D&O insurance is based on many factors, and specifically assets, but revenues too are considered. However, the underwriting is based on consolidated financials, meaning the revenues and/or assets of the company are *not broken down by State*. It's possible the insureds would have such information, but it would be a pretty big burden for them to collect all the data from their various states/divisions etc. I could envision receiving material push back from retailers, and then frustration pushback by the insureds. Most of our insureds are privately held companies or non profit companies. They are not going to have the accounting staff or necessary resources to be able to provide this information."

- "Publicly traded entities are the only Insured's that I have worked with that track business activities by state. Most of the business that we handle are not publicly traded or are non-profit. The Insured's would not track this information."

- "Current applications do not capture this data. Revenue per state has nothing to do with the pricing of this exposure. Revenue in any given state has nothing to do with where a claim may be brought on this coverage.

Directors & Officers Liability, SEC Liability, EPLI, Professional Liability/E & O, Patent Infringement and Intellectual Property

Proposal: Allocate by "Revenue Generated," "Headcount," or "Number of Professionals"

➢ "Revenues or headcount by state is not typically a part of the underwriting criteria requested, therefore additional burden is placed on the broker, agent and insured to develop information not part of the insuring process. This may also force some insured's into creating additional procedures to capture this information."

Professional Liability

Proposal: Allocate by Revenues (receipts) or Number of Professionals in each state

➢ "In the case of say professional liability, it is not uncommon for a professional to practice in both states, how does one allocate on the basis of number of professionals per state as proposed? Ultimately this would come back to the insured who may or may not track this on the basis proposed."

Professional Liability (Managed Care E&O)

Proposal: Allocate by Revenues (receipts) or Number of Professionals in each state

➢ "The breakout of applicant's/Insured's business activity information by state is not included as a standard underwriting question, meaning that the submission material received does not provide this breakout. I believe this information would be arduous for the Insured to provide as most professional liability activities are performed under contract with the third party client and the revenue would be aggregated by client but not necessarily within the state in which the business activities were conducted. "

General Liability, Excess Liability & Umbrella Liability (All Operations)

Proposal: Allocate by Payroll, Square Footage, Cost of Contract, Sales, Receipts, Number of Events, et al., depending on the specific operation

➢ "Because these coverages often contain combinations of a multitude of exposures, breaking out premiums in this degree of detail would generate a tax filing process *more time consuming and onerous than the entire placement process of the account combined*. Also, certain exposures are co-mingled such as Premises Operations & Manufacturers & Contractors or Products and Completed Operations. Insured's would not track separate information between Products & Completed Operations or Contractual."

General Liability: Products Liability

Proposal: Allocate by Sales in each state

➢ "For instance when a product is manufactured and then distributed in multiple states, it is impossible to determine if that product has actually been used in the state distributed or some other state. [Our firm] exists in a city whose metro area is spread over two states. Product moves freely from state to state...how would we determine where the exposure is located?"

➢ "While the applicant may, after great effort, discover an estimation of revenue by state, there is no correlation to the coverage, pricing, nor potential claims based on that initial segmentation. And revenue in their local state by them will have no bearing on the use of their products by state, as those products migrate across state lines. Where they sell the product wholesale, seldom has any correlation to where the product is used, after retail sales."

Umbrella Liability

Proposal: Allocate in each state, depending on type of operation insured

➢ "True umbrella deals with rating for GL, Fire Legal, Transportation, and many other coverages – all of which are rated differently. Where payroll or gross receipts occur in the primary coverage rating, does not match the exposure, and therefore the premium generated. Using the primary rating breakdown is not possible, as the umbrella carrier does not necessarily write any primary policies. Therefore, all such rating materials would have to be collected again, making the rating/submission process doubly difficult for the insured, retailer, wholesaler, and market. "

➢ "Umbrella liability provides excess limits for a combination of coverages, including not only General Liability, but also Auto Liability, Employers Liability and Advertising Liability, and may include excess Professional Liability or D&O coverage. Allocating based on the principal GL exposure might be possible with respect to some of our insureds but often would be completely unrepresentative of the risk. It makes little sense to allocate most Umbrella anywhere other than the home office of the insured."

Railroad Protective

Proposal: Allocate by "Miles of Track" in each state

➢ "Miles of Track in each state is not a part of underwriting criteria and therefore creates development of additional information not relative to insuring process."

Inland Marine

Proposal: Allocate by TIV in each state

➢ "Inland marine [is] by [its] very definition is transient. How do we determine where the equipment is and for how long?"

General Liability & Property (Apartment Houses)

Proposal: Allocate property by TIV and liability by square footage in each state

➢ "Property and Liability for Apartment houses may actually be rated on number of doors. TIV does not tell the story for allocation. The value of an apartment building is vastly different per square foot in California versus Oklahoma however the exposure for most perils is significantly more hazardous in Oklahoma excluding EQ of course."

General Liability (Special Events)

Proposal: Allocate by "Number of Events" in each state

➢ "Number of Events in each state is not indicative of the exposure basis by state. (Some events may be small and others much larger.)"

➢ "Rating may be based on admissions, or may be flat. In either case, number of events in each state is not presently tracked for insurance purposes. In fact, the number of events is unlikely to be known, or even estimated, at the time coverage is placed."

Media Liability

Proposal: Allocate by TIV in each state

➢ "TIV is not relevant to the exposure on this coverage, by state or otherwise. While certain media coverages do include physical damage to media property, the exposure to liability is not relative to TIV."

➢ "This makes no sense: Media Liability primarily insures against defamation and invasion of privacy claims as well as copyright and/or trademark infringement. There are no "values" to be tallied for TIV! Coverage is bought by publishers for printed (and electronic materials) published by them; by film and TV producers for their productions; by advertisers for their advertising content, etc. There is no consistent way to allocate this. Consider a book publisher protected by media liability. The exposure arises from every book sold, but perhaps years after that book has been sold...and there is no way for a publisher to track where its books are being sold."

Marine

Proposal: Allocate by TIV or "Principal Berthing Location" in each state

- "By nature this is a mobile exposure often located in various states at different times."

Property

Proposal: Allocate by TIV in each state

- "In the cases where all properties are scheduled, with values assigned to specific property locations, THEN the taxation and policy limits CAN match. However, anytime a "blanket theory" is used on property, then the policy values would NOT be used, and the policy would need a declared RATING value for the schedule of properties, by state, to be provided. As the RATING value changed over time with endorsements, the tax allocation would follow. Samples follow:

Scheduled Buildings

NY: 4,500,000	Premium: $9,000
NJ: 10,000,000	Premium: 10,000
MN: 16,000,000	Premium: 8,000

TIV: 30.5mil total values, allocate the premium based on RATES CHARGED BY LOCATION, rather than as a percent of the total premium based on percent of TIV in that particular state. In this case, we all know (insured, retailer, wholesaler, carrier, reinsurer) just how much premium was charged for every state.

Blanket Concepts

NY: 30,500,000 blanket	Premium: $27,000
NJ: included	
MN: included	

30.5mil total values, same total premium, but how much value is allocated by state is impossible – the very POINT OF BLANKET coverage. The policy will have a "blended" rate to be used during the term ($0.0885245 per 100 value). Inside the carrier pricing, though no value per location can be determined on the policy, they know that they RATED THIS RISK using the values of 4.5, 10, and 16mil allocated by the states. Therefore, multiply those ESTIMATED VALUES USED FOR RATING times the POLICY RATE, to get per state premium allocations.

These two samples, though using the same apparent values and premiums, will not allocate the same, because the blanket theory is involved, allowing the insured to use whatever portion of the limit they need at the time of the loss (subject to contract terms). This is the point of having such contract terms be available, and the taxation collection issues should not serve to inhibit these terms of advantage to the insureds. Instead, state taxation assignment should be given as simple a mechanic as possible, to not inhibit trade, practice, operation, or coverage ability of the insureds nor the industry providing those options."

General Comments

➢ "I have reviewed the allocation basis being proposed by NIMA and would find it problematic for [our firm] to comply and continue to adequately serve our customer base. State of domicile for most GL, Excess and Umbrella coverage make sense and have been the norm for many years.

This applies really to almost all third party coverage. [Examples, for Products Liability and Professional Liability included above.]

Ultimately this would come back to the insured who may or may not track this on the basis proposed."

➢ "It would be very difficult to separate these exposures by state. Primarily we would have to rely solely on our retail agent and insured to provide this information at quoting / binding. Many of these exposure bases are a moving target, ie # of staff members per state, headcount per state. This would vary during the policy period and would be a nightmare at audit to go back and recalculate the actual premium and then determine what the original premium / taxes were based on. The cost involved to manually calculate many of these exposures by state would be cost prohibitive and would in fact cause some brokers to not even look at multi state accounts because the paperwork involved to handle this sort of undertaking."

➢ "Tax filings will be slowed down by this onerous a process, and to avoid creating an additional burden for the insureds, information will be "guesstimated" and not accurate."

➢ "According to our SL tax filing staff, this complex a reporting procedure will force wholesalers and/or retailers to add staff for the purposes of filing documents."

➢ "Multi-National Accounts—Often, policies contain exposures outside the US. Would these premiums/exposures be exempt from SL taxes since they cannot be allocated by state? For liability exposures, taxes go to the US state of domicile."

➢ Multi-state Package Policy: "One of our biggest insureds bought another operation in Oklahoma and in Florida during the policy period. Not only did we have General Liability, we also had property coverage, umbella and cargo coverage all written on a non admitted basis. Trying to determine the additional premium [separately] for Oklahoma and Florida [would be] very difficult. The insured and our agent [would] not understand why it was necessary to split out the information, payroll and receipts for each state."

➢ "One of our insured's purchased a business in Mississippi so it was necessary to endorse our Texas policy to provide coverage for the new location. The operation in MS was small so the additional premium to add the new location was small. However, sometime during the policy term, the insured decided to move most of his main operation to MS due to the cost of living. We had to go back rerate the entire policy and return tax to Texas and charge more MS tax on the new exposure basis of the new payroll and receipts. It was very difficult for the insured to provide us with exact effective dates as to when each employee moved from Texas to MS. Therefore, this created an enormous amount of paperwork on the insured and of course they do not understand why it is necessary to break the employees, payroll and receipts by each location."

➢ "Attached please find a collection of applications used in our brokerage business for a wide variety of risks.* You will note that not a single one breaks out revenue or head count by state.

Also attached are some rating worksheets for our GL program business, one for Fire suppression, one for Security Guards and one for Janitorial companies. These sheets demonstrate the fact that carriers are not presently using any state by state detail for rating purposes.

The bottom line is that many insureds will not have the information contemplated by the allocation method proposed by NIMA. Most insured's will not necessarily capture data in this fashion.
The reporting proposed by the NAIC (NIMA) places an additional and undue burden on insureds. The applications and rating worksheets confirm that the information sought by the NAIC/NIMA is not presently provided nor is it presently requested of the consumer. The commissioners will be placing undue burden and expense on the very constituency they are obliged to protect by asking them to gather this additional detail to present to their agents in order to obtain coverage.

The carriers themselves rate coverage on a class basis not on a state basis. Therefore, the sole purpose of this request for additional information will be to provide information for tax allocation. The data itself provides no utility in the insurance transaction other than to indicate tax allocation. Indeed this is contrary to the spirit of the NRRA."

➢ "Like a state income tax can be levied on a company that does business all over the country, at the choice of the resident home state, so too should a premium tax follow on exact theory, without allocation to other states. The only exception may be REAL PROPERTY – not including inland marine that serves for the good of transportation, and generally or frequently crosses state lines in a manner that cannot be tracked without an onerous system of state border checks. In the case of real property, it is something that all parties to the insurance transaction can agree, already track, and can easily be reported. And since the state systems serve real property in similar relation to their values, it is a fair system, however, the states involved must have the understanding that INSURANCE LIMITS are not the same as STATE VALUES. Because there is the theory of "blanket" limits within insurance policies, but those limits seldom match the estimated values, and the very point of this theory is to allow such a mis-match, then the states would need to accept "rated estimation" values, rather than "scheduled policy" values."

Background

The responding firms represented a cross-section of smaller, regional and national wholesale brokers. Within two working days, response had been received from seven. One indicated that the nature of its business was such that it really would not be impacted and a second noted that, due to the nature of risks written, they would need substantial, costly changes to their systems to collect and submit the information required.

No attempt was made to obtain response on each of the specific allocation bases. Instead, the purpose was to provide a quick sampling, with comments limited to impact on specific business actually handled by the firm. If a methodology as has been proposed is to be used, input should be obtained for each type of risk from wholesalers that actually handle each type of risk to determine the feasibility of providing break-out of exposure by state, and, if feasible, the basis. Alternatively, a much simpler approach should be sought.

Hank Haldeman & Dave Leonard
Co-Chairs, NAPSLO Legislative Committee

Testimony Before
The Subcommittee on Insurance, Housing
and Community Opportunity
Committee on Financial Services
United States House of Representatives

Regarding:
"Insurance Oversight: Policy Implications for U.S. Consumers,
Businesses and Jobs"

Thursday, July 28, 2011

John M. Huff
Director, State of Missouri
Department of Insurance,
Financial Institutions and Professional Registration
As Non-Voting Member of the Financial Stability Oversight Council

Introduction

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today. My name is John Huff, and I am Director of the Department of Insurance, Financial Institutions and Professional Registration for the State of Missouri. I serve as a non-voting member of the Financial Stability Oversight Council (FSOC), and I am also a member of the National Association of Insurance Commissioners (NAIC). I am very pleased to be here with our current president, Iowa Insurance Commissioner Susan Voss.

Today, I will discuss my and the NAIC's views on systemic risk in the insurance sector and highlight the activities of FSOC that could impact that sector. I will also discuss the continued issue of my ability to consult with fellow insurance regulators on confidential matters, an issue of earlier testimony and a problem that has drawn significant Congressional intervention, for which we are grateful. Finally, I will touch upon our international work regarding the criteria to identify any insurers that may be global systemically important financial institutions (GSIFIs).

Systemic Risk and Insurance

Insurance is a unique product. While bank products involve consumer deposits that are subject to withdrawal on demand at any time, insurance policies involve up-front payment in exchange for a legal promise to pay benefits in the event of a future loss. U.S. insurance companies are subject to stringent capital requirements, limits on the nature and extent of investments, and quarterly analysis and periodic examinations. This stringent regulatory oversight enabled the insurance sector to weather the financial crisis better than other sectors.

It is my view and that of the NAIC that traditional insurance products and activities do not typically create systemic risk. However, connections with other financial activities and non-insurance affiliates may expose some insurers to the impact of systemic risk, and certain products may provide a conduit for systemic risk. In those cases and any other situations where companies become troubled, insurance regulators do have the ability to ring fence insurers in order to protect policyholder assets. The longer-term nature of insurance products makes this an effective tool, and enables regulators to wind troubled insurers down in an orderly manner.

FSOC Activities

It has truly been a privilege to serve on FSOC with colleagues dedicated to protecting the stability of our nation's financial system and preventing another financial crisis. While there has been some criticism regarding the pace of the Council's activities—some believe it is moving too slowly, others believe it is moving too quickly—I firmly believe that our goal must not be just for timely completion, but more importantly for the work to be done right.

Much of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was not aimed at the insurance sector, but there are a number of FSOC activities that will have an impact on insurance companies and regulators. We are watching how FSOC's activity regarding the Volcker Rule could impact the insurance sector. Section 619 of Dodd-Frank prohibits insured banking institutions and their affiliates from engaging in proprietary trading and subjects designated non-bank financial companies conducting such activities to more stringent regulatory standards. FSOC was directed to conduct a study on Volcker Rule implementation, which confirmed the statute's indication that the business of insurance should be accommodated by permitting affected insurers to continue to engage in investment activities that are in compliance with state laws and regulations. It also highlighted the importance of consulting with state insurance regulators throughout the process, to solicit regulator opinions on defining key terms used in the statute, and to involve regulators in the process used to determine whether an insured depository institution or the stability of the United States is threatened by the investment activities of an affiliated insurer even though such activities are in compliance with relevant investment laws.

As for the non-bank designation process, members of the Council have previously testified in other fora that the Council intends to provide additional guidance and seek additional public comment. While I defer to the U.S. Treasury Department on the specifics, FSOC continues to work hard on this guidance with the intention of releasing it for comment in the near future. I encourage all insurance sector participants to weigh in on that guidance.

On Tuesday, FSOC released its first annual report. This report was a significant undertaking by all the members of FSOC and I applaud them and their staffs for all of their hard work. That report underscores that insurance companies generally withstood the financial crisis well and have since strengthened their balance sheets. While, during the financial crisis, insurers felt some stress as asset prices fell and noncore activities such as securities lending resulted in some losses, the insurance sector remained strong and there was little, if any, disruption to their ability to provide insurance services to consumers and businesses. The report also describes several of the regulatory improvements that the insurance regulators have completed since the financial crisis, a number of which are detailed in Commissioner Voss' testimony, including improvements to insurer disclosure requirements regarding derivatives and their securities lending programs, and the changes that were made to more precisely evaluate the credit quality of insurer investments to commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS).

The report identified certain areas that my fellow insurance regulators and I need to continue to monitor closely including insurer exposures to CMBS, RMBS, municipal bonds, and specific European investments. The report also notes the difficulties that financial guaranty and mortgage guaranty insurers, a relatively small portion of the industry, continue to face. These problems are associated with the decline in house prices and market activity, the increased volume in residential real estate foreclosures, and the impairment in the RMBS markets. We also need to continue to monitor the higher than usual claims activity that the property and casualty sector continues to experience as a result of the severe weather and flooding in several parts of the United States including my home state of Missouri.

Finally, during earlier testimony before the Financial Services Oversight and Investigations Subcommittee, I expressed my concerns about the adequate representation of insurance interests, and specifically insurance regulators, on FSOC. At that time, Michael McRaith had been appointed to the position of Director of the Federal Insurance Office (FIO), but he had not yet started, and President Obama had not yet nominated Roy Woodall to fill the Council's voting position of someone with insurance expertise. I also spoke of my restriction from consulting with my fellow insurance regulators on matters before FSOC, despite the fact that state regulation of insurance has thrived based on collaboration and information sharing in confidential settings for many years.

It is critically important that the uniqueness of the insurance business model and the strength of the state-based system of insurance regulation be recognized as FSOC monitors systemic risk and determines which non-bank institutions to designate as systemically important financial institutions (SIFIs). It is the joint responsibility of the FIO Director, the voting member with insurance expertise, and the state insurance regulator to be vigilant in this regard.

I am very pleased that Mike McRaith, the former Director of the Illinois Department of Insurance, is now the first Director of the Federal Insurance Office. Mr. McRaith is well-known among NAIC members; in fact, he was serving as our Secretary-Treasurer immediately before his appointment to the federal government. Our officers have had a number of productive conversations with Mr. McRaith and his colleagues since he came to Washington. I consider us very fortunate to have him in this new role.

I am also pleased that Roy Woodall has been nominated by President Obama to be FSOC's first voting member with insurance expertise. Mr. Woodall will bring both regulatory and industry experience to bear on FSOC decisions, and we current state regulators enjoyed working with him in his most recent capacity at the U.S. Treasury Department. We are watching his confirmation proceedings in the Senate with great interest, and I am very hopeful that he will be able to join the Council as soon as possible.

Thus, I can testify today that FSOC is very close to having its full complement of insurance members on board, as required by statute. Regrettably, I must report that the ability of state insurance regulators to provide input regarding FSOC's important work remains extremely limited. I am still unable to communicate with my fellow commissioners on a confidential basis regarding the matters under consideration by FSOC that portend changes to our regulatory process and that could impact insurers and state insurance markets.

I remain hopeful that my fellow state insurance regulators will soon be able to work with the Council; such collaboration could even take place through a smaller group of designated regulators, who represent the needs of different regions and markets in the country. I firmly believe that such consultation will be vitally important in the coming months as FSOC determines the criteria to be used to identify systemically important non-bank firms and evaluates firms for such designations.

The Council must decide how it will handle state insurance regulator involvement after the formal designation of an insurance company as a SIFI. FSOC, in conjunction with the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC), will review resolution plans filed by designated companies; under Dodd-Frank, FSOC is meant to assist both entities in this regard. FSOC has the authority to recommend to the Federal Reserve heightened prudential standards to apply to designated firms; that work will be undertaken by the Council's heightened prudential standards committee. In the event that any insurers are designated, the ability of the Council to receive advice and counsel from my fellow insurance regulators who are involved in the day-to-day regulation of such companies will be critical. Adequate communication among regulators is especially important in light of our continuing international work on designations of GSIFIs.

Identification of Insurance GSIFIs

The NAIC is a founding member of the International Association of Insurance Supervisors (IAIS), and is a committed participant in all of the major IAIS committees and subcommittees. The NAIC also serves as Vice-Chair of the IAIS Financial Stability Committee, which is currently in the process of developing a methodology for identifying insurers that may be GSIFIs. As part of that work, the insurance regulatory representatives to the Financial Stability Committee can consult with and seek the advice of fellow insurance regulators. It is critical for these members to access unique expertise in particular subject areas; such knowledge helps ensure that appropriate methodologies are being considered, and gives members the insights of the hands-on regulators with respect to discussions of particular companies. This is a marked contrast to my work on FSOC where I cannot share confidential information with my fellow regulators in order to obtain their fully-informed views on such issues.

The financial crisis has clearly demonstrated that it is not sufficient to focus on a single sector any longer, and we are increasingly being asked to participate in global dialogues with international supervisors and standard setters from across the financial spectrum. The US, represented by the Treasury Department, the Federal Reserve Board of Governors, and the Securities and Exchange Commission, is a member of the Financial Stability Board (FSB), which is engaging directly with the IAIS on critical issues including GSIFI identification. Our involvement in this process is critical since the FSB is a bank-centric organization; through the IAIS, we continue to stress that the insurance business model needs to be distinguished from the banking business model when applying new regulatory requirements. Additionally, the Treasury Department coordinates input from the various functional regulators or their representatives on FSB projects and priorities, and we have urged the US FSB representatives to reinforce our input and concerns.

The FSB has taken on an increasingly active role in attempting to coordinate regulatory developments around the globe. I would encourage federal regulators and legislators alike to be mindful of both the scope and speed of the board's activity, as this institution should be restrained from acquiring supranational regulatory authorities. Appropriate deference should be provided to the regulatory authorities of member nations.

Conclusion

Throughout the debate over and the implementation of Dodd-Frank, my fellow regulators and I have fought to deliver the message that "one size does not fit all." Both the nature and regulation of insurance products are fundamentally different from the nature and regulation of banking and securities instruments. We remain hopeful that these differences will be adequately acknowledged and accommodated domestically by FSOC and internationally in bodies such as the IAIS and FSB.

Thank you again for the opportunity to testify today. I would be happy to answer any questions.

ACLI
Financial Security. For Life.

STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

SUBCOMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

OF THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

ON

INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR U.S. CONSUMERS, BUSINESSES AND JOBS

July 28, 2011

Statement Made by
Gary E. Hughes
Executive Vice President & General Counsel
American Council of Life Insurers

Chairman Biggert, Ranking Member Gutierrez and members of the Subcommittee, my name is Gary Hughes, and I am Executive Vice President and General Counsel of the American Council of Life Insurers ("ACLI"). ACLI is the principal trade association for U.S. life insurance companies, and its 312 member companies account for 91% of total life insurance company assets, 91% of the life insurance premiums, and 92% of annuity considerations in the United States.

The ACLI appreciates the opportunity to discuss with you a number of issues that are of particular importance to the life insurance business and the policy implications those issues raise. Had this hearing occurred just a few years ago, our focus would have been quite different and would have involved largely domestic matters and our efforts to make U.S.-based insurance regulation operate more efficiently. Today, in addition to implementing those provisions of the Dodd-Frank Act that are relevant to our business, international regulatory issues dominate our agenda, and the attendant practical and competitive implications are indeed significant.

One contextual observation at the outset may help put in proper perspective the importance of these international issues to all life insurance companies. Many people instinctively think these issues are of concern only to life insurers conducting business both domestically as well as internationally. That, however, is not the case. In due time, state insurance regulators as well as the Securities and Exchange Commission and the Financial Accounting Standards Board will have to make critical decisions regarding the extent to which U.S. solvency and accounting standards should be harmonized with global standards. These decisions have the potential to fundamentally alter the prudential regulation of all life insurers, large and small, regardless of whether their business is conducted domestically or internationally.

With this background, I would like to discuss the importance of fully implementing the intent of Congress under the Dodd Frank Act in creating the Federal Insurance Office or FIO. Specifically, I would like to address the critical role the FIO should play in the development and representation of U.S. federal interests on international insurance and competitiveness issues and with respect to important domestic regulatory matters.

Today, the number of domestic and foreign agencies, offices, departments and organizations involved to some degree in the regulation of, or standard setting for, the insurance business is imposing to say the least. I would like to make five observations regarding ACLI's views on U.S. governmental representation of insurance in this increasingly complex global environment.

First, we respect the role of state insurance supervisors as the micro-prudential regulators of insurance in the U.S. We appreciate their coordination with U.S. industry on the development of international standards and their bilateral engagement with specific markets where the resolution of commercial and regulatory issues benefits from their expertise and involvement.

Second, we appreciate the ongoing role the National Association of Insurance Commissioners ("NAIC") in the development of international standards as the association of U.S. prudential regulators. State regulators are, and will remain, a critical part of the U.S. financial services regulatory architecture.

Third, in the area of trade negotiation and trade facilitation, we appreciate the support we receive from the Office of the United States Trade Representative and the U.S. Commerce Department. As a result of USTR efforts, our industry contributes over $85 billion annually to the services trade balance through premiums we earn in markets which have been opened through U.S. advocacy. We hope this positive record will continue with the swift introduction and passage of the Korea, Colombia and Panama free trade agreements and the timely conclusion of both the Trans Pacific Partnership and the WTO Doha Round.

Fourth, despite the strong support we receive from state regulators and U.S. government negotiators, there continues to be a gap in the representation of U.S. national interest in international insurance and financial services forums. We sincerely hope this gap can be filled by the FIO and other offices within the Treasury Department once those offices are fully staffed and provided with the resources needed to develop U.S. international insurance policy and represent the U.S. on international insurance issues as provided in Dodd Frank.

And fifth, as noted earlier, ACLI's advocacy on insurance regulation has shifted from a largely domestic exercise to a much more global endeavor. For example, in recent weeks ACLI President and CEO Dirk Kempthorne has met with European Commission leaders on insurance supervision, members of the European Parliament, and the leadership of our industry counterpart associations in numerous other countries. And in the weeks ahead, he will be participating in the annual meeting of the International Association of Insurance Supervisors ("IAIS") in South Korea. He will also be visiting Beijing and Tokyo to meet with our local member company managers, the respective U.S. Ambassadors and their staffs, and local government officials. The purpose of these meetings is to discuss the challenges we face in their markets and perhaps more importantly the direction of global regulatory convergence efforts.

In sum, ACLI believes that despite a strong state-based insurance regulatory system in the U.S., there is a pressing and immediate need for the FIO to engage in the representation of U.S. national interests and in so doing fill what is essentially an "international insurance representation gap." The ACLI first identified this representation gap in 2001 when we noted to the Administration and Congress the disconnect between the U.S. and other major trading partners in Western Europe, Japan and South Korea. These countries were reorganizing their financial regulatory services into a single unified Financial Service Authority model combining banking, securities and insurance supervisors into an integrated whole. This change created a definitional inconsistency as these governments engaged the U.S. on financial services regulatory coordination and cooperation initiatives. The scope of their understanding of financial services included all sectors, and the U.S. was continually forced to clarify that under U.S. representation financial services included all sectors except insurance.

While this problem was often overcome on an informal basis by having the Treasury Department coordinate with state insurance officials, this ad hoc approach had its limits, since state officials never had the necessary governmental credentials or clearances to serve as the U.S. counterpart to our major trade partners and allies in efforts to improve global financial stability. In particular, state insurance officials are by and large only tasked with, and provided authority over, micro-prudential supervision, while macro-prudential powers in the U.S. continue to reside at the federal level. This constant disconnect with the national authorities of other major global markets was highlighted during the recent global financial crisis and was the driving force in the decision by Congress to invest the FIO with its international policymaking portfolio.

We are hopeful that the FIO will eventually be able to fill this gap, but we are concerned that it may not able to do so in the near term due to a lack of adequate staffing and budget. This element of timing is of particular concern because of impending deadlines associated with the two issues discussed below. If these deadlines are not met by robust and coordinated U.S. state and federal governmental advocacy, the result may be harm to U.S. global competitiveness.

Specifically, I would like to highlight the two issues where we urge the Secretary of the Treasury to provide immediate resources to the FIO and enable its immediate and effective engagement. The first is the effort to develop criteria and a methodology for the designation of globally systemically important financial institutions ("G-SIFIs"). The second is the effort to ensure that the U.S. is determined to be eligible for a deemed equivalency finding under the third country provisions of the European Union's Solvency II Directive. This later initiative also involves critical transitional measures being considered in the European Council and the European Parliament as part of the Omnibus II package of legislation expected to be voted upon early in 2012.

Regarding G-SIFIs, ACLI has been able to track this initiative through our observer status within the IAIS, which has been tasked by the Financial Stability Board ("FSB") with the development of applicable criteria and methodologies. We have asked that members of the NAIC provide us with their views on the G-SIFI process and asked for their support in addressing industry concerns about aspects of the initiative we believe are inconsistent with state insurance laws. Unfortunately these individuals have been limited in their ability to communicate with us on the specifics of the G-SIFI process because of admonitions by the IAIS that this is a closed, regulator-only exercise.

While the IAIS has provided a limited opportunity for industry comment, we are concerned by the process the IAIS is using for its fact gathering and determinations. This concern is the result of questions and comments we have received from IAIS staff, who appear to lack the background in macro-prudential insurance regulatory policy. It also results from the fact that a number of non-U.S. regulators have asserted that there are no G-SIFIs in their home country jurisdictions, thus protecting their domestic insurers from heightened regulation. The intent of these national regulators appears to be the creation of commercial winners and losers. We believe this is contrary to the intent of the G-20 member countries and inconsistent with U.S. government policy. While we have expressed our concerns in this regard to the NAIC and state insurance regulators, we have been advised that they are not in a position to help address these issues.

In light of the above, we see an immediate and essential role for the FIO with respect to the G-SIFI issue. It can act as a strong federal advocate and demand that the focus of the exercise be a balanced outcome that does not harm the competitiveness of U.S. insurance and reinsurance companies. The office can also provide input to, and coordinate with, the rest of the Treasury Department, the Federal Reserve and the SEC. These three agencies are the U.S. voting members to the FSB, which as noted above is the body tasked by the G-20 to coordinate the G-SIFI initiative.

Having FIO work with the broader U.S. FSB delegation is also important in that it would provide us with a clearer understanding of the expectations being placed on the IAIS by the FSB. The IAIS has indicated that it is under intense pressure from the FSB to develop a criteria and methodology for G-SIFI designation by September. This pressure for speed appears to have trumped calls for additional dialogue with industry and academic experts to examine how, if at all, insurers pose a global systemic threat. Haste in this regard is even more problematic given the fact that the life insurance industry and state insurance regulators have raised extremely serious concerns with a proposed IAIS data collection initiative that in our judgment would clearly contravene applicable U.S. state confidentiality laws.

To be clear, ACLI supports the IAIS, and our concerns on some of its work streams are not meant to suggest that IAIS members should abandon their efforts. We do, however, urge members to be realistic in their expectations. The IAIS is the designated forum for discussion of new and innovative ideas, but whatever standards it develops must be evolutionary and not revolutionary, lest they infringe upon the constitutional processes of the member states and undermine the political legitimacy of the overall effort.

The IAIS is recognized by international organizations as the international standards setter for insurance. For example, the IMF uses IAIS standards as the metric in what are essentially neutral audits of the adequacy of nations' regulatory systems for insurance. These audits have a substantial impact on the way legislators in respective countries approach their efforts to enact insurance-related legislation. It is this well-established IAIS role that requires active participation by the FIO and the broader Treasury Department as well as the Federal Reserve and SEC. These institutions, as the voting U.S. members of the FSB, must coordinate with U.S. micro-prudential state regulators to assure that the U.S. has coherent and effective international insurance policy that represents the U.S. National interest.

The second area where we believe there is a pressing need for immediate FIO engagement is working with the European Commission to ensure that the U.S. is found eligible for a deemed equivalency determination under Solvency II. The trans-Atlantic insurance market is the largest two-way flow of insurance globally, and should the U.S. be deemed as non-equivalent, U.S. insurers would be placed at a significant global competitive disadvantage. Non-equivalency would also carry with it the potential to increase costs, and correspondingly rates, for U.S. insurance consumers.

State insurance regulators have done an admirable job of representing the U.S. in this process to date, but with the passage of Dodd Frank there is a strong expectation by the European Commission and European Member States that the U.S. federal government will take an active role in the equivalency deliberations. The next meeting of the European Commission, the European Insurance and Occupational Pension Authority (the European regulatory association) and U.S. state insurance regulators will be on September 6th in Frankfurt. We urge the FIO to participate in this discussion as a full partner and voice the support of the U.S. government for this equivalency determination.

While the global insurance issues discussed above are unquestionably a top priority for the life insurance industry, we would be remiss if we did not reference our top domestic regulatory priority, which is the implementation of those aspects of Dodd-Frank pertaining to life insurance companies. While the attendant policy issues are largely resolved, the outcome of the various rulemaking initiatives will, more than anything else, shape our views on this new law. Among the issues that are of most importance to life insurers are the use of derivatives to hedge portfolio risks, the Volcker Rule, holding company regulation by the Federal Reserve for those insurance enterprises that control a bank or thrift, a harmonized standard of care for broker-dealers and investment advisors, and the Financial Stability Oversight Counsel's process for identifying systemically important financial institutions ("SIFIs") and the regulatory consequences of such a designation.

Our principal concern with respect to each of these issues is that a fair balance be struck between regulatory interests on the one hand and legitimate insurance business practices on the other. Our concern in this regard is heightened by the fact that there has been a tendency throughout the legislative process and into the rulemaking process to view these issues through a bank lens. As we have noted repeatedly, life insurers are quite distinct from banks in terms of their fundamental business model, their financial structure and their regulatory oversight, and a one-size-fits-all approach to rulemaking will not produce workable results. In the absence of a federal insurance regulator and with the FIO not yet fully being funded and staffed, striking this balance has often proved difficult. Going forward, we hope that the FIO can work constructively with the insurance industry and its prudential regulators to better address these types of issues.

We would also like to note that the FIO has a role in the area of reinsurance. We have urged state insurance regulators and the NAIC to coordinate with FIO regarding any determinations on the quality of reinsurer supervision in other countries. Such determinations will be a key to the implementation of reinsurance collateral reform in the U.S. as currently envisioned by state insurance regulators. ACLI believes Congress intended FIO to have a role with respect to reinsurance collateral, and we believe the office should be afforded the resources necessary to support that role.

The Dodd Frank Act empowers the FIO to set U.S. international insurance policy. In addition, it is intended to serve as the focal point within the federal government for information and expertise on the business of insurance. To carry out these roles effectively, it will require human, economic and technical resources. Failure to provide these resources will risk harming U.S. competitiveness domestically and globally, and for this reason we urge that the FIO be fully funded and staffed as expeditiously as possible.

We sincerely appreciate this Subcommittee holding a hearing on matters that are of vital importance to insurance companies, to insurance regulation and to those who rely on our products and services.

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THE COUNCIL
The Council of Insurance Agents & Brokers

STATEMENT OF CLAY JACKSON
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA AND
THE COUNCIL OF INSURANCE AGENTS & BROKERS

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES

July 28, 2011

Good morning Chairwoman Biggert, Ranking Member Gutierrez, and Members of the subcommittee. My name is Clay Jackson, and I am Senior Vice President and Regional Agency Manager of the Nashville-based BB&T Cooper, Love, Jackson, Thornton & Harwell. My insurance brokerage firm is an active member of both the Independent Insurance Agents & Brokers of America (IIABA) and The Council of Insurance Agents and Brokers (CIAB).

IIABA and CIAB and the broader insurance agent and broker community share a common outlook on the important regulatory issues that have been the focus of the subcommittee's recent efforts. This morning, I'd like to share our thoughts and concerns regarding the implementation of the surplus lines reforms enacted by Congress last year and address our strong support for licensing reform and the NARAB II proposal.

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. The Nonadmitted and Reinsurance Reform Act (NRRA) – enacted into law in July 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) – sought to simplify the regulatory structure governing such coverage on a multistate basis by limiting the regulatory authority over a surplus lines transaction to the home state of the insured and by setting federal standards for the collection of surplus lines premium taxes, insurer eligibility, and commercial purchaser exemptions. Most of the provisions of the NRRA went into effect last week – on July 21st.

The goal behind the NRRA was not to federalize regulation of surplus lines insurance, nor was it to deregulate. Rather, the intent was to bring about common sense reforms of surplus lines rules at the state level – maintaining state regulation but creating a structure that does away with the conflicting, overlapping rules that made compliance difficult and, in fact, impossible in some instances.

Surplus lines reform was heavily championed by both the insurance agent/broker community and the commercial insureds who are the primary utilizers of surplus lines insurance products. The fundamental thrust of the reform provisions was to require that only a single set of regulations govern a surplus lines transaction – those of the insured's "home state." This was accompanied by Congressional support for the creation of a single, State-based surplus lines regulatory system that would include a harmonious tax payment and allocation mechanism. As of July 21st – the effective date of the NRRA provisions – the States, however, have done everything but create any such harmonious and rationale regulatory system. Indeed, nine States have agreed to enter into a compact, the "Surplus Lines Insurance Multistate Compliance Compact" or "SLIMPACT" that would be designed to create a single comprehensive surplus lines regulatory regime, including a tax allocation mechanism, but another eleven States (and Puerto Rico) have opted to enter into a separate, stand-alone tax sharing agreement (the "Nonadmitted Insurance Multi-State Agreement" or "NIMA").

Because of the inability of the States to reach a consensus, nine of the largest States – California, Idaho, Illinois, Minnesota, Missouri, New York, Pennsylvania, Virginia and Washington – opted out of any tax allocation system and will retain 100 percent of the surplus lines premium taxes that will be paid by their "home state" insureds. The core NRRA surplus lines directive essentially orders this result and it is a result that will be the most administratively and economically efficient. The remaining twenty-one States (and the District of Columbia) are still evaluating – in one form or another – how best to proceed. We have sent letters to all of those States, asking them to follow California, Illinois, New York, Pennsylvania and the other States who have opted out of the dysfunctional sharing mechanisms and to each create a simple, single-state regulation and taxation mechanism. We ask you to urge them to do the same.

While IIABA and CIAB remain concerned with and focused on the proper implementation of the NRRA surplus lines provisions, we also believe insurance regulation must continue to advance in other ways. Perhaps the most conspicuous and ripe area in need of reform is the producer licensing system. Despite the well-intentioned efforts of some in the regulatory community, the difficult truth is that sufficient progress has not been achieved and the need for effective licensing reform is greater than ever.

Congress first addressed licensing issues nearly a dozen years ago, but the scope of reform anticipated has not been delivered. True reciprocity and interstate consistency remain elusive. Compliance remains costly, burdensome and time consuming, and many firms and agencies retain expensive vendors or hire dedicated staff people to achieve compliance with state licensing laws. For smaller businesses, which lack the staff and resources of larger competitors, the cost and complexity of ongoing licensing compliance is especially burdensome.

IIABA and CIAB believe the most efficient and effective way to address these problems is with the NARAB II legislation that previously passed the House in 2008 and 2010. This legislation has once again been introduced by Representatives Randy Neugebauer and David Scott and currently has nearly sixty cosponsors.

The NARAB II proposal would provide agents and brokers with a long-awaited vehicle for obtaining and maintaining licenses on a multistate basis. It would eliminate barriers faced by agents who operate in multiple states, establish licensing reciprocity, and create a one-stop facility for those who require nonresident licenses.

The bill discretely utilizes targeted congressional action to produce marketplace efficiencies and is deferential to states' rights. H.R. 1112 merely addresses marketplace entry and leaves regulatory authority in the hands of state officials. The proposal does nothing to limit or hinder the ability of state regulators to enforce state marketplace, trade practice, and consumer protection laws. State officials will continue to oversee the conduct of producers, investigate complaints, and take enforcement and disciplinary action against any agent or broker who violates the law.

In short, the NARAB II proposal would strengthen insurance regulation, reduce unnecessary redundancies and regulatory costs, and enable the industry to more effectively serve the needs of insurance buyers – and it would achieve these results without displacing state regulatory oversight.

Let me also say a quick word about the work of the Financial Stability Oversight Council and its deliberations regarding which non-bank firms should be designated as systemically important. Insurance companies (especially property and casualty insurers) present **very** little, if any, systemic risk to the economy, especially when compared to other financial services providers. Insurers have lower leverage ratios and generally hold greater amounts of capital in relation to their liabilities, thereby reducing their vulnerability to market shocks. Additionally, the very nature of insurance products makes them inherently less vulnerable to systemic risk. Insurance companies are financed by premiums paid in advance and payments are subject to the occurrence of insured events, substantially reducing the likelihood a "run-on-the-bank" scenario. As an additional safeguard, state regulators have broad authority to take insurers into receivership, effectively "walling off" their assets from the holding company and providing priority to policyholders. We urge FSOC to take these factors into account as it makes its determinations of which entities are considered "systemically risky."

IIABA and CIAB thank the subcommittee for its efforts – past and present – to implement tangible and effective marketplace improvements. We appreciate your focus on ensuring that the surplus lines reforms of the Dodd-Frank Act are implemented as intended, and we look forward to working with you on the much-needed NARAB II proposal.

American Insurance Association

THE FINANCIAL SERVICES ROUNDTABLE
Financing America's Economy

Statement by

Leigh Ann Pusey

President & CEO

American Insurance Association

in coordination with

Financial Services Roundtable

before the

Committee on Financial Services

Subcommittee on Insurance, Housing and Community Opportunity

United States House of Representatives

July 28, 2011

Good morning. Chairman Biggert, Ranking Member Gutierrez and other members of the Committee. Thank you for the opportunity to testify on behalf of the American Insurance Association (AIA), in coordination with the Financial Services Roundtable (Roundtable), on key issues facing the insurance industry in the wake of the global financial crisis. My name is Leigh Ann Pusey, and I am the President and Chief Executive Officer of AIA.

AIA represents approximately 300 of the nation's leading insurers that write more than $117 billion in premiums each year. Our member companies offer all types of property-casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage for small businesses, workers' compensation, homeowners insurance, medical malpractice coverage, and product liability insurance. The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer.

Our member companies, as well as the members of the Roundtable, have a significant interest in the insurance issues being discussed before the Committee today, and the policy implications of those issues. While we are active in the implementation of many of these policy discussions, I would like to use my time today to focus on a few key priorities that are emerging from the confluence of regulatory reform discussions occurring at the international, federal, and state levels. Further, within these priorities, I would like to highlight the important role that the Federal Insurance Office (FIO), created under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), can play in keeping U.S. insurers competitive, preserving the viability of the U.S. insurance regulatory system, and furthering the growth of free and open insurance markets around the world. My focus on the FIO's key role, particularly in the international arena, is intended to complement the good work of the state regulators and of the National Association of Insurance Commissioners (NAIC). They have been instrumental in explaining the strengths of U.S. financial regulation of insurers. My recommendations today are intended to emphasize the important unifying mission that is outlined for the FIO in the Dodd-Frank Act. If the FIO functions as statutorily intended, the U.S. government and the state regulators will be able to present a national voice on international insurance matters.

In this context, I would like to spend the balance of my time today on three international regulatory priorities and a domestic regulatory priority for AIA and the Roundtable. First, while the domestic implementation of the Dodd-Frank Act is at the forefront of our agenda and occupies a great deal of time and resources, we have a joint stake in ensuring that the process for designating, supervising and resolving so-called "global systemically important financial institutions" – or G-SIFIs – is fair, open, transparent and, above all, does not overtake U.S. regulatory efforts to implement parallel provisions of the Dodd-Frank Act.

Second, we share common ground in ensuring that our state-based insurance regulatory system is viewed as equivalent to the European Union's Solvency II initiative, even if the standards that are utilized are not identical.

Third, we have a mutual interest in broadening market access, reducing trade barriers, and ensuring that regulatory initiatives do not impair private markets.

Finally, we believe that new restrictions in the Dodd-Frank Act, such as the Volcker Rule, should address gaps in current regulation and perceived high-risk activities; and not supplant existing bank or insurance regulation.

THE FINANCIAL CRISIS AND ITS GLOBAL IMPLICATIONS FOR INSURANCE

It is critical to note the insurance industry emerged from the recent financial crisis safe and strong. The resilience of insurance throughout the crisis is a testament to the insurance industry business model and its supporting regulatory structure – a combination that has yielded low-leveraged businesses that maintain conservative investments and are focused on safety and soundness. Accordingly, it is imperative to maintaining the strength of our business that regulators – both here and abroad – appreciate the unique nature of the industry when developing new rules.

AIA has led U.S. property-casualty industry efforts to engage at the international level amidst wide-ranging proposed global financial standards intended to prevent or mitigate the next financial crisis. For many years, we have worked cooperatively with the International Association of Insurance Supervisors (IAIS), the NAIC, the Organization for Economic Cooperation and Development (OECD), Treasury, Congress, and European Union instrumentalities on a number of important international insurance regulatory and trade fronts.

This overarching global debate over emerging financial regulation impacts all companies, whether or not they are engaged in markets outside the U.S. The plain truth is that such regulation – done hastily or without due regard to the insurance business model and national regulatory standards that embrace that model - may increase regulatory risk at the expense of private markets. We have grave concerns that the consequences of misguided regulation at an international level could yield: (a) less competition for U.S. insurers; (b) an erosion of sound, flexible regulatory standards; (c) private markets with a declining number of consumer product and company choices; and (d) duplicative, contradictory regulatory standards with the potential for regulatory gaps and confusion. Under a worst case scenario, significant shifts in the regulatory framework could make it difficult for insurers to enter or remain in insurance markets, threaten the solvency of companies by siphoning away additional capital, reduce insurance availability, or push more consumers into insurance residual markets.

Solvency II

In the U.S., the NAIC launched its Solvency Modernization Initiative (SMI) in 2008. The SMI covers five broad areas: Statutory Accounting, Reinsurance, Capital Requirements, Group Supervision, and Corporate Governance/Risk Management.

At the global level, regulatory framework changes are being debated in a variety of arenas, but have been driven by the EU's Solvency II initiative – an effort that began prior to the global financial crisis, but which shifted direction following the crisis. Solvency II is not simply a financial regulatory initiative, but a comprehensive restructuring of capital requirements, risk management measures, disclosure and reporting standards, and group-wide requirements and supervision. Many of the elements at the core of Solvency II have also migrated to the IAIS in the form of proposed new IAIS Insurance Core Principles (ICPs), which could provide extensive new authority to every insurance supervisor at the national level in countries that adopt the ICPs in legislative form. This may lead to the same types of adverse regulatory consequences that we could face if Solvency II concerns are not resolved.

The major work product under both the SMI and Solvency II has been developed in the area of group supervision. Domestically, the NAIC has focused on revisions to the model insurance holding company law and regulation, which the NAIC wants to use to provide U.S. insurance regulators with more information about the activities and risks of the broader group outside of the insurance entity. The group supervision standards here and abroad reflect the differences in regulatory approach between the U.S. and the EU. Solvency II also contains an external component – the third-country equivalence process – that has been the principal source of pressure on the U.S. and the state-based insurance regulatory system. Under Solvency II, non-EU countries have been invited to become "equivalent" jurisdictions in terms of their regulatory treatment of reinsurance, group solvency calculation, and group supervision. The consequences of a negative equivalence determination, including having to meet solvency requirements absent the capital from U.S. operations, are potentially severe both for U.S. insurers doing business in European Economic Area (EEA) countries and for EEA-based insurers with U.S. operations. The European Commission earlier announced that the United States would not be included in the first wave of countries assessed for equivalence. However, any implications of a negative equivalence determination might be suspended for up to 5 years, but subject to specified transition measures. During this period, the U.S. will be evaluated as to its progress towards convergence with the Solvency II approach.

The pressure being applied through the Solvency II equivalence process is being reinforced by the International Monetary Fund (IMF), which conducts periodic examinations of national regulatory systems, effectively grading those systems under its Financial Sector Assessment Program (FSAP), using the ICPs as global insurance regulatory measures. The U.S. insurance regulatory system is purportedly scheduled for an FSAP evaluation in 2012.

AIA's concerns with the Solvency II initiative stem from three principal sources: (a) the competitive consequences of a negative third-country equivalence determination for those companies with U.S. insurance operations: (b) potentially unworkable financial regulatory standards to be adopted in the U.S. as a result of the Solvency II process; and (c) new layers of added regulatory burden that may further stress the ability for insurers to do business. This regulation can take many forms, including unnecessarily high capital requirements and new reporting mandates, controls over internal operations of well-functioning insurers, and other supervisory measures that could add dramatically to costs while adding little to consumer benefits. Often, these mandates arise out of the failure to recognize the unique, strong and successful business model of insurance, which differs significantly from other sectors.

Global Systemically Important Financial Institutions

Separate and apart from Solvency II and similar initiatives, the crisis itself generated the debate about systemic risk and the heightened supervision that should apply to financial institutions that present such a threat. The debate in the U.S. yielded the Dodd-Frank Act, which addresses four different regulatory aspects of systemic risk: (1) monitoring the activities of financial institutions; (2) the process of designating "systemically important" financial institutions (SIFIs) for heightened federal prudential supervision; (3) the prudential regulatory standards applicable to SIFIs; and (4) the orderly resolution of failing SIFIs.

At the international level, the Financial Stability Board (FSB) was designated by the G-20 to coordinate global financial services regulatory activities to prevent future crises. The FSB has directed IAIS to report on which insurers should be designated as G-SIFIs. IAIS has also incorporated the notion of systemic risk into its new ICPs. To respond to the FSB, IAIS has proposed a data collection program to determine the extent to which insurers may be engaged in non-core activities.

There are a number of dangers associated with the premature designation of G-SIFIs. First, for companies that are screened under this process, any public mention of a screened company or confidential data could compromise the company's competitive position and risk the public disclosure of financially-sensitive information. Further, to the extent that the company is misidentified as a G-SIFI, the business reputation of the company could be put at risk. Second, to the extent that the G-SIFI process outpaces the substantive implementation of the parallel Dodd-Frank Act provisions in the U.S., the outcome of the international determination could unduly and unfairly influence the SIFI determinations here. Third, the factors utilized and the standards developed could vary, meaning that an insurance company could be scrutinized differently in the U.S. and internationally. Inconsistencies could be exacerbated, as legislatures and regulators adopt varied standards in different nations. The process is intended to regulate shadow financial activities that amass and concentrate risk across financial sectors in those companies that engage in those unregulated activities, not those that spread risk and diversify exposure according to business models and regulation that prevent customer runs on the institutions.

Trade and Market Access

As important as they are, Solvency II and the G-SIFI process are not the only international challenges for U.S. insurers. Barriers to market access, usually through regulation, continue to be a major issue for insurers. Annually, U.S. property-casualty insurers are deprived of nearly $40 billion annually in premium, and related jobs, due to foreign barriers to trade, according to the U.S. International Trade Commission in its 2009 report, Property and Casualty Insurance Services: Competitive Conditions in Foreign Markets.

Examples of regulatory barriers include undue difficulty in opening local offices, controls on geographic expansion, and restrictions on product offering. One example is a government limit on the amount of foreign reinsurance. Yet another example is the constant danger of government-backed insurers unfairly profiting from cultural advantages and/or not being subject to regulation of the kind imposed on insurance companies.

We are strong supporters of the three pending free trade agreements. They include good language on regulatory transparency, consultation, and unfair competition from government-controlled insurers. Once in effect, they should open important markets with large growth opportunities for U.S. insurers.

THE FEDERAL INSURANCE OFFICE AND U.S. GOVERNMENT PARTICIPATION INTERNATIONALLY

In each of these discussions – whether they involve Solvency II, the G-SIFI process, market access, or other critical international insurance issues - it is vitally important for the FIO to be at the table alongside other key representatives providing a unified national voice. Congress envisioned this role for the FIO when it authorized the office "to coordinate Federal efforts and develop Federal policy" on prudential international insurance matters, represent the U.S. before the IAIS, assist the Treasury in negotiating bi-lateral or multi-lateral insurance agreements on prudential issues, and to make recommendations to the FSOC regarding SIFI designations involving insurers. (See 31 U.S.C. § 301 note – Federal Insurance Office Act of 2010 [§ 313(c)]). The Dodd-Frank Act has outlined a complimentary role for the FIO on the international stage, serving as a bridge to the state-based regulatory system.

VOLCKER RULE

We believe that Congress did not intend Bank-Owned Life Insurance (BOLI) contracts to be subject to the restrictions and prohibitions of the Volcker Rule. While this exclusion of BOLI contracts from the reach of the Volcker Rule is clear for BOLI contracts supported by an insurer's general account or by a separate account of the insurer that is registered with the SEC, the analysis with respect to other BOLI (*e.g.*, private placement separate account BOLI products) may be less clear. With respect to such products, we believe that any similarity between BOLI and traditional hedge funds and private equity funds is largely restricted to the fact that all rely on the exemptions under 3(c)(1) or 3(c)(7) of the Investment Company Act. Banking entities purchase BOLI insurance policies as a tax effective means to manage the risks associated with employee benefit obligations. Applicable banking supervisory guidance prohibits the purchase of BOLI for speculative purposes[1] and establishes a number of requirements that must be fulfilled by the purchasing bank entity, including rigorous, continual oversight of such policies by the banking entity's senior management. The guidance also requires that the assets in a BOLI separate account be invested in bank-eligible securities, with an exception for certain non-bank-eligible investments that act as a hedge against existing obligations of the banking entity. Insurance and tax laws also dictate requirements affecting this product. Further, the insurance and tax law requirements applicable to a BOLI separate account mean that a banking entity does not, and cannot, own or control the assets in the separate account and cannot make investment decisions regarding the individual assets in a separate account.

The BOLI insurance structure is dependent upon an insurance company establishing a "separate account" on its books to support each BOLI policy. Insurance company separate accounts are used to hold portfolios of securities that are dedicated to supporting specific variable insurance contracts (while all other insurance company assets not held in such separate accounts are held in the "general account" and support the insurance company's general insurance and other liabilities). The separate account structure is attractive because assets held in a separate account are not available to satisfy the general creditors of the insurance company. In

[1] Interagency Statement on the Purchase and Risk Management of Life Insurance (2004) (the "Interagency Guidance") (generally imposing restrictions on banks and savings associations with respect to the purchase and use of life insurance; specifically requiring, *inter alia*, that banks and savings associations not purchase life insurance for speculation and that banks and savings associations have a comprehensive risk management process for purchasing and holding life insurance).

the event of an insurance company failure, any assets in a separate account supporting a BOLI policy cannot be used to satisfy general creditors' claims against the insurance company. To achieve the tax deferral benefit for the increase in value of the assets in a separate account supporting a BOLI policy, the purchasing banking entity may not exercise investment control over the assets in the separate account, and the variable insurance policies are structured to prevent investment control by the policyholder. The courts however, have determined that the separate account itself is an "investment company" and therefore the separate account either must be registered as such with the SEC or rely on an exemption from registration under the Investment Company Act. The separate account that supports a BOLI policy will generally rely on either the 3(c)(1) or 3(c)(7) exemption under the Investment Company Act, and hence the separate account technically meets the definition of a hedge fund or private equity fund for purposes of the Volcker Rule.

Beyond the separate account's reliance on the 3(c)(1) or 3(c)(7) exemptions, however, BOLI bears no resemblance to the traditional hedge funds or private equity funds that the Volcker Rule is intended to police.

First, as noted, existing bank regulatory guidance prohibits the purchase of BOLI policies for speculative purposes.[2] It also prohibits depository institutions from holding life insurance in excess of their risk of loss or cost to be recovered, requires investments in separate accounts to comply with the limits on bank eligible investments (with the minor exception for certain equity investments reflecting a very high degree of correlation used to hedge specific equity-linked obligations under an employee benefit plan), and limits the cash surrender value of BOLI to be

[2] Interagency Guidance at 2.

25% or less of capital.[3] Management must approve the purchase of BOLI policies and exercise regular oversight over their operation, performance and fulfillment of bank regulatory requirements.[4]

Insurance law provides that a banking entity purchasing an insurance policy supported by a separate account does not have a legal ownership interest in the separate account; rather the assets of the separate account are considered assets of the insurance company (and, as noted above, the assets are insulated from claims of the insurance company's general creditors).

Finally, under applicable tax law, once a BOLI policy is established, a policyholder cannot exercise investment discretion over the assets in the separate account; if a bank entity policyholder did so, it would be subject to severe negative tax consequences (basically by forfeiting the economic benefit of the policy).[5] The fact that the BOLI policyholder does not exercise investment discretion over the underlying assets supporting the policy makes it difficult, if not impossible, for the policyholder to take on excess risk through the policy itself, which stands as further evidence that BOLI lacks the attributes of a mechanism for evading the Volcker Rule.

In sum, because BOLI accounts do not have any of the attributes that give rise to the same concerns as the hedge funds and private equity funds that the Volcker Rule was meant to restrict, neither the insurance company separate accounts that support BOLI variable insurance contracts nor the insurance contracts themselves should be deemed hedge funds or private equity funds for purposes of the Volcker Rule.

[3] *See generally* Interagency Guidance.
[4] *Id.*
[5] *Id.* at 13.

CONCLUSION

The insurance industry emerged from the financial crisis in a strong position with capacity to expand and there is rapidly growing demand for more insurance from many parts of the world. Today, despite the industry's outlook, we face regulatory issues on the international stage that may challenge our way of doing business and the regulatory structure that defines that business model. Now, more than ever, we need the combined strength of the U.S. government and state regulators, working together, to allow the U.S. industry to compete on a level playing field globally and to promote new market opportunities. Thank you again for the opportunity to testify, and I would be happy to answer any questions.

Testimony of J Eric Smith
House Financial Services Committee
Subcommittee on Insurance, Housing and Community Opportunity
July 28, 2011

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, on behalf of the Reinsurance Association of America (RAA) and my company, Swiss Re, thank you for the opportunity to testify at today's hearing on the impact of insurance-related public policy on U.S. consumers, businesses and jobs. My name is Eric Smith, and I am president and CEO of Swiss Re Americas. Swiss Re is a global reinsurance company with a highly-skilled workforce of several thousand U.S. employees, and we transact U.S. business through U.S. tax-paying companies. The RAA is a U.S. national trade association representing the interests of reinsurers doing business in the United States and other parts of the world. My testimony today will focus on key public policies stemming from the Dodd-Frank Act that affect reinsurers.

We applaud your leadership in creating the Federal Insurance Office (FIO). Chairman Biggert, you must be particularly proud that the first FIO director comes from the great state of Illinois. The FIO has a fundamental role to play here at home and in the international insurance regulatory arena, and the importance of its role as expert advisor to the Financial Stability Oversight Council (FSOC) cannot be overstated. FIO Director Michael McRaith's background as a state insurance regulator, and his experience supervising global insurance groups and working on international issues, will be a real compliment to the U.S. government. We look forward to working with him and the entire team at the FIO and Treasury as they carry out the agency's new and important insurance-related functions.

The Subcommittee has come to know that reinsurance is an important part of the insurance mechanism. It is an efficient risk management tool that assists insurance companies and governments in improving their insurance capacity and enhancing financial security. You and I as consumers manage our own personal risks by purchasing protections including life, auto and home insurance, and businesses manage their risks by purchasing a variety of insurance products. Insurance companies and governments also protect their interests by purchasing reinsurance. For example, insurers and state-run property insurance programs use reinsurance in managing the cost of natural catastrophe risks, such as flood, wind and earthquake. In fact, reinsurers have helped the United States recover from every major catastrophe over the past century. To provide a sense of what this means, here are a few facts. Sixty percent of the insured losses related to the events of September 11, 2001, were absorbed by the global reinsurance industry. In 2005, sixty-one percent of Hurricanes Katrina, Rita and Wilma insured losses were ultimately borne by reinsurers, and in 2008, approximately one-third of insured losses from Hurricane Ike and Gustav were reinsured. Swiss Re has helped Americans rebuild from every major U.S. catastrophe since the 1906 earthquake.

Reinsurance is a global business and reinsurers are global companies. Without global scale, reinsurers would not be able to absorb peak risks. Diversification is achieved by spreading risks across different geographical regions and lines of business in order to increase the number of mutually independent risks. As a result, loss events within particular product lines or local markets can be absorbed by the return on other policies not affected by those events. These global diversification concepts provide efficient and effective protection to reinsurance purchasers.

Information Gathering and Knowledge Sharing

We understand there is lingering concern about some elements of the Dodd-Frank Act. The FIO is not one of those elements and we offer our strong support for its establishment. For the first time, there is a federal agency responsible for understanding the insurance and reinsurance industry. We believe the FIO is a step in the right direction. We urge Congress and the Administration to provide sufficient resources to the FIO to ensure that it meets its responsibilities, which are indeed essential functions.

The FIO was given data collection authority in order to fill a gap in federal level knowledge of the industry, and in evaluating systemic risk. In carrying out these functions, we believe the FIO should coordinate closely with the Office of Financial Research, the National Association of Insurance Commissioners and other existing regulatory and non-regulatory sources. In this way, the FIO can utilize credible, available data and avoid duplicative reporting requests, which can be a drain on business resources. Since the FIO serves as one of the few but very important insurance-focused members on the FSOC, we believe the FIO's data collection, analysis, and advice are essential to the FSOC's deliberations and determinations on insurance sector risk. The RAA has for many years collected data and provided analysis on the reinsurance sector to regulators and public policy makers, and we hope to share that information with the FIO as a constructive resource not readily available from traditional regulatory filings. Similarly Swiss Re is one of the world's leading risk experts with a research time horizon of 50 to 100 years. We believe we have a responsibility to share our risk research with governments around the world. It is important that the relevant confidentiality provisions of the Dodd-Frank Act are fully effectuated to ensure that confidential company information can be safely shared

The Dodd-Frank Act requires the FIO to produce and deliver certain reports to Congress, including one on improving U.S. insurance regulation and another on the breadth and scope of the global reinsurance market. We believe these reports should include specific discussion of states' implementation of section 531 of the Act and related state-based collateral reform efforts, and section 532 of the Act. By including these provisions, we believe Congress was clear that it expects specific outcomes in the regulation of insurers and reinsurers, and that the FIO will monitor and report on these specific aspects of the U.S. insurance regulatory system. We hope there will be room for relevant industry input and objective analysis in these reports.

U.S. Engagement Internationally on Insurance

We fully support the FIO taking an active and meaningful role internationally on insurance regulatory matters. There are many international forums where important insurance-related issues are being addressed, and it is clear from the Dodd-Frank Act that Congress intends for the United States to act and speak with one voice in these forums going forward. Whether it is at the International Association of Insurance Supervisors, working with the G-20 and Financial Stability Board, the OECD, WTO or elsewhere, the FIO has the power to be the clear and consistent voice of the United States, reflecting the interests of U.S. policyholders, insurers, reinsurers, and the U.S. insurance regulatory community. One of the most important powers that Dodd Frank granted to the FIO is the authority to enter into and enforce international agreements with foreign regulators on prudential insurance regulatory measures. We believe this authority should be used to ensure equitable treatment for domestic and foreign insurers and reinsurers alike, and to promote job creation and foster innovation and economic growth in the United States.

Financial Services Oversight Council and Systemic Risk

This Subcommittee knows that the Dodd-Frank Act empowers the FSOC to create criteria for evaluating and designating non-bank financial institutions as "systemically relevant", and to subject those companies to heightened regulatory scrutiny. It is an important reminder for all of us that Congress set the statutory bar for systemic risk designation very high. In order for a U.S. or foreign non-bank financial company to be subjected to heightened prudential regulation and Federal Reserve Board supervision, the FSOC must find that the material financial stress, or the ongoing activities of the company, could pose a threat to the financial stability of the United States. This high standard was established by Congress in order to mitigate unintended consequences that could result from uninformed systemic risk designations, which could have lasting effects on a company, its employees and shareowners and the United States economy.

In order to understand the unique nature of the insurance and reinsurance industry, we urge the FSOC to rely heavily on the expertise of its three insurance-focused members when considering the sector. We urge the FSOC to de-link all considerations for designating insurance companies from those used for banking institutions. The business models and roles in society of insurance companies and banks are distinct and should be considered separately.

There are important lessons learned from the financial crisis. First, the significant gap in U.S. supervision of company groups must be closed in insurance regulation. A single regulator must be responsible for understanding and regulating a group. Second, systemic risk regulators must consider activities first—rather than entities first—if they hope to effectively identify potential systemically important non-bank financial institutions. The RAA has undertaken extensive quantitative systemic risk analysis using non-bank criteria proposed by systemic risk regulators as the basis for the work. The results of this effort indicate that reinsurers and reinsurance are not the source of systemic risk. The RAA findings are attached to this statement for the record and shown as Appendix A.

On behalf of the Reinsurance Association of America and my company, Swiss Re, thank you for the opportunity to appear before the Subcommittee. We are gratified that Congress continues to remain engaged in insurance-related matters.

Appendix A

EVALUATING SYSTEMIC RISK

Property & Casualty Reinsurance

Reinsurance Association of America
Washington, DC
July 2011

RAA

Definitions of Systemic Risk

Financial Stability Board

- "The risk of disruption to the flow of financial services that is (i) caused by an impairment of all or parts of the financial system; and (ii) has the potential to have serious negative consequences for the real economy."
- "Fundamental to this definition is the notion that systemic risk is associated with negative externalities and/or market failure and that a financial institution's failure or malfunction may impair the operation of the financial system and/or the real economy. "

Definitions of Systemic Risk

Federal Reserve Chairman Ben Bernanke

"The possibility that the failure of a large interconnected firm could lead to a breakdown in the wider financial system; systemic risks threaten the stability of the financial system as a whole and consequently the broader economy, not just that of one or two institutions."

RAA

(Re)insurance Business Model

The (re)insurance business model is not a source of systemic risk.

- It is fundamentally different from other financial institutions.
- Inverted production cycle: obligations are pre-funded at the inception of the policyholder relationship.
- Lack of leverage limits interconnectedness.
- (Re)insurance obligations are not callable. Cash outflows may only be triggered by an external insured event.
- Insured loss events are not correlated with financial crises or economic cycles.

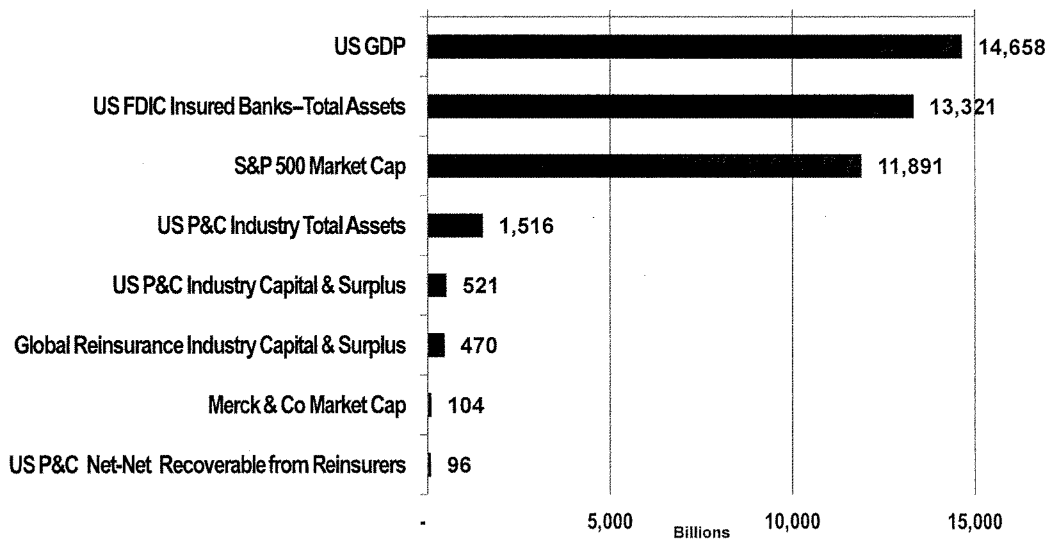
RAA

FSB Systemic Risk Attributes

The FSB has identified four primary attributes for the evaluation of systemic risk

- Size
- Interconnectedness
- Substitutability
- Time / Liquidity

Size - Reinsurance recoverables are not systemic risk amounts relative to U.S. financial markets or economy.



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Size - Small relative size / reinsurance credit risk is further reduced by offsetting amounts.

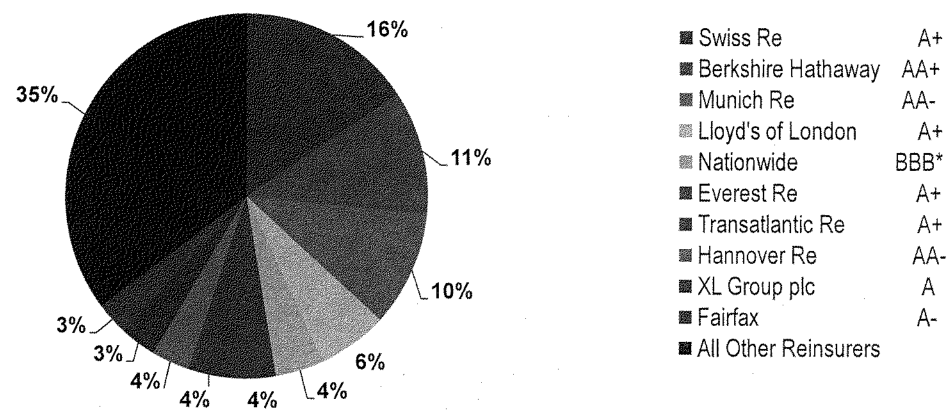
U.S. P&C Industry Exposure to Reinsurance Recoverables

2009 Results	**$ Millions**
Total Assets	1,515,926
Reinsurance Recoverables on Paid Losses	14,444
Policyholders' Surplus	520,600
Net Recoverables (Paid, Case & IBNR, net of amounts owed to reinsurer)	233,816
Less Funds Held	23,502
Less LOCs, Trust Funds, & Other Collateral	114,654
Equals Net Net Recoverable	95,661
Recoverables Analysis	
Net Net Recoverable as % of PHS	18.4%
Net Net Recoverable as % of Total Assets	6.3%
Recoverable on Paid Loss as % of PHS	2.8%
Recoverable on Paid Loss as % of Total Assets	1.0%

Interconnectedness - Insurance risk is spread broadly and globally. Reinsurance is a net credit enhancement for many cedents.

Top US P&C Groups

3rd Party Reinsurance Net-Net Recoverables Concentration



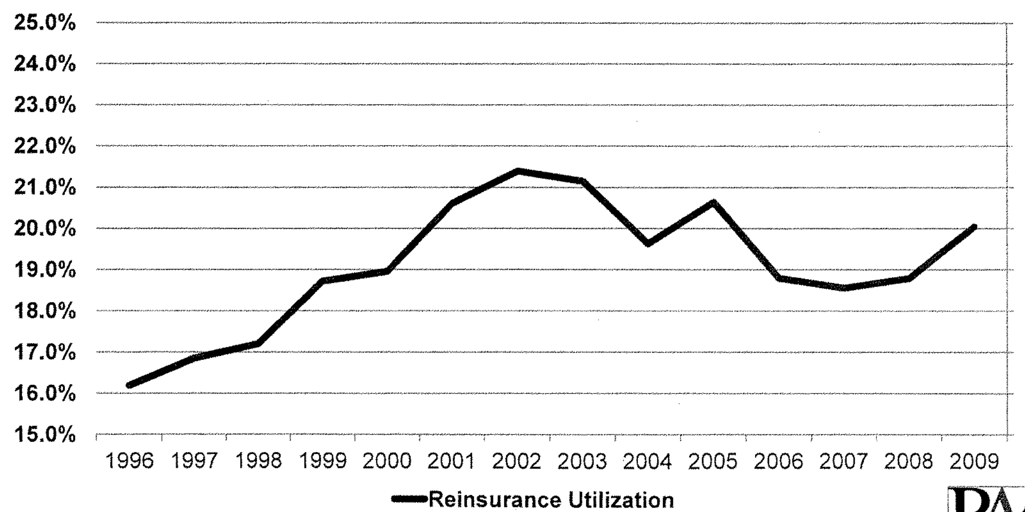
*Note: Nationwide's AM Best Rating = A+. Approximately 90% of this net-net recoverable is due from Nationwide Indemnity Co., an entity used to run off asbestos and environmental obligations.

RAA

Interconnectedness & Substitutability

P&C industry cessions to the global reinsurance market are only 20% of gross premium.

U.S. P&C Industry: Reinsurance Utilization Rates



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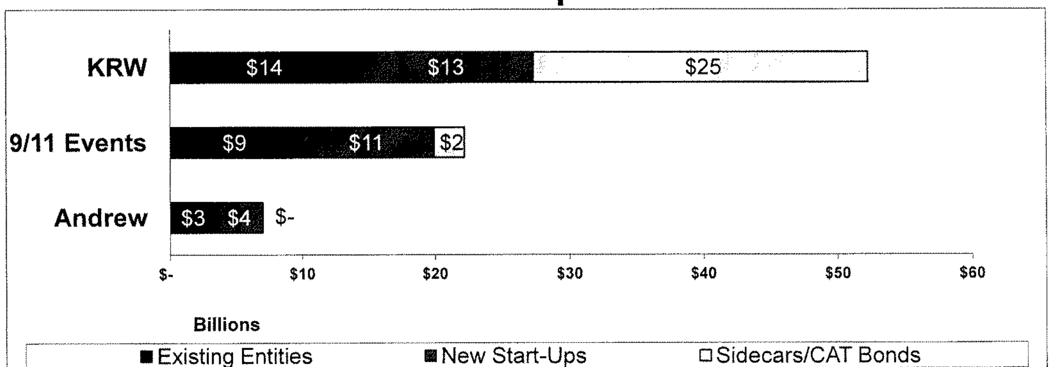
Substitutability - Capital is quickly replaced following significant events. Alternative forms of capital have become more prevalent.

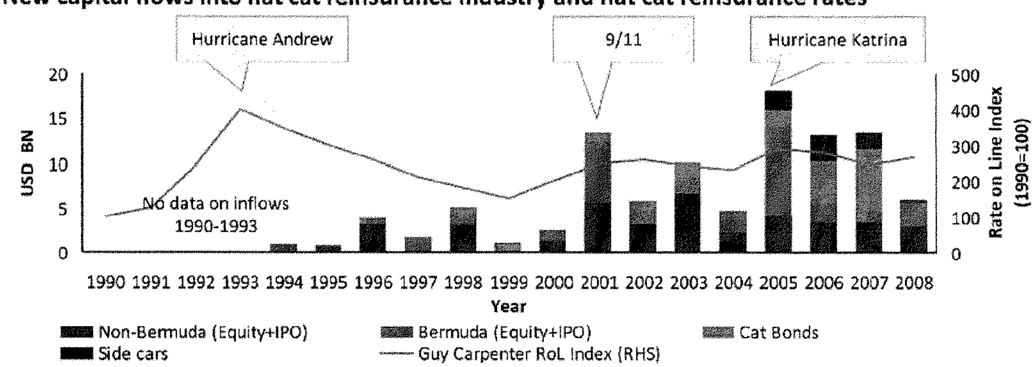
Post CAT-Event Capital Raised



	KRW	9/11 Events	Andrew
New Capital Raised	$52.2 B	$22.2 B	$7.0 B
Est. Loss Industry Wide	$65.0 B	$41.0 B	$15.5 B
New Capital % of Est. Loss	80.3%	54.1%	45.2%

New capital inflow into reinsurance shows high substitutability

New capital flows into nat cat reinsurance industry and nat cat reinsurance rates



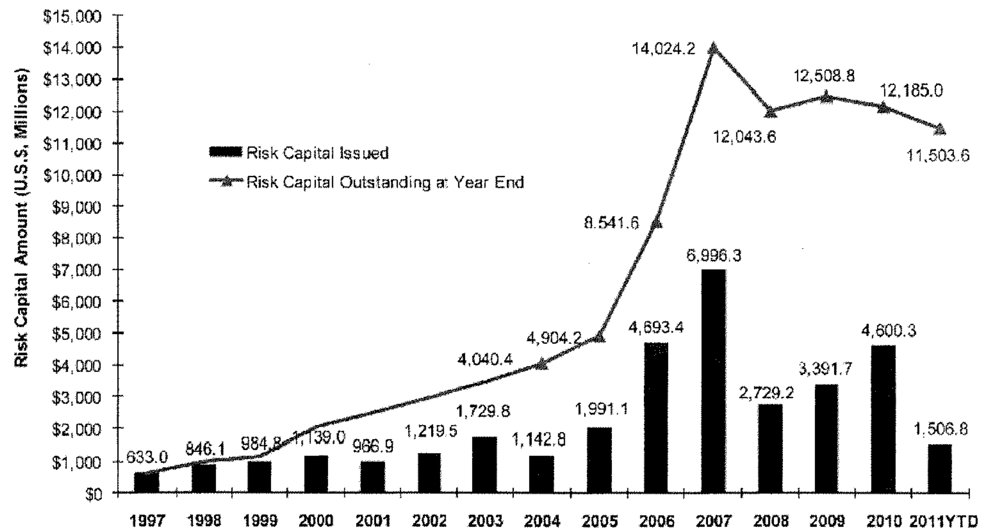
- Reinsurance rates increase for years following big catastrophes
- This attracts steady inflow of capital in the industry through new entrants or capital increases of existing reinsurers (including side cars and cat bonds)
- In addition, capital base of reinsurers is also progressively rebuilt after large natural catastrophes through the higher reinsurance rates

Reinsurance capacity has always increased after natural catastrophes – insurance capacity is highly substitutable

 Source: Thomson, Guy Carpenter, AON Benfield, Dealogic, Oliver Wyman analysis

Substitutability - Catastrophe Bond Market Growth Continues

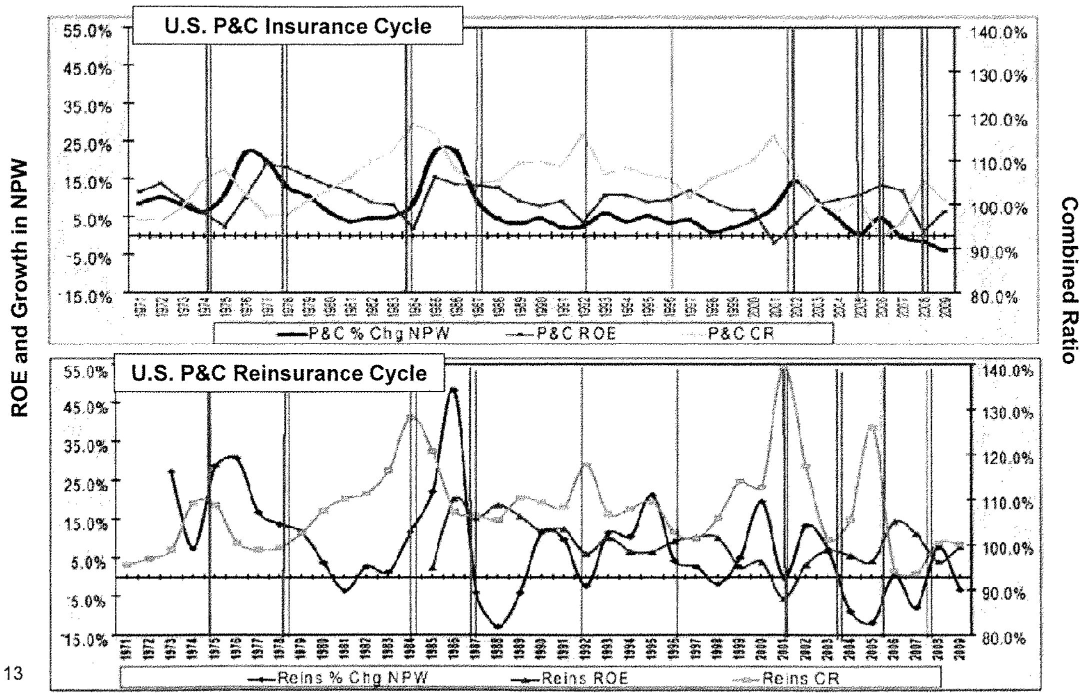
RISK CAPITAL ISSUED AND OUTSTANDING, 1997 – 2011 YTD



Source: GC Securities *As of May 31, 2011*

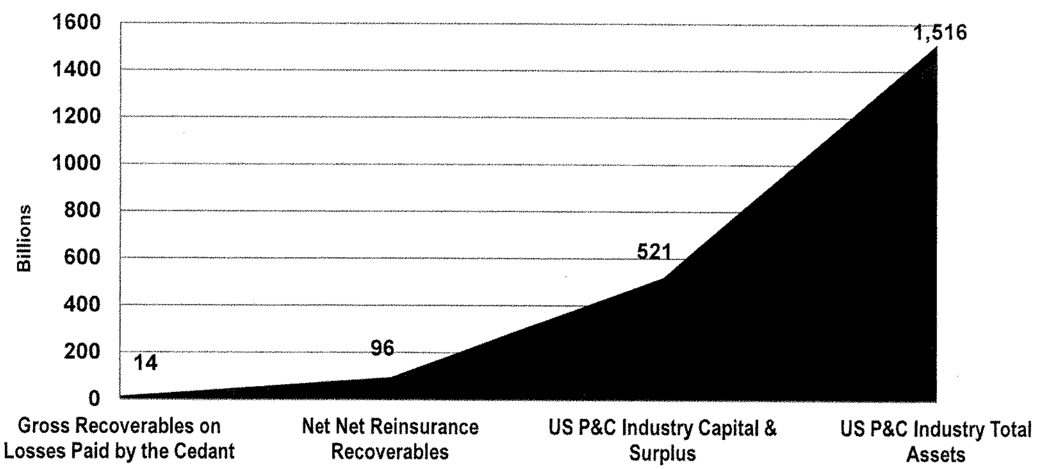
RAA

Substitutability - Capital flows follow the reinsurance cycle.
Reinsurance absorbs insurance industry volatility and adds stability.



Time/Liquidity - (Re)insurance obligations are not callable, significantly limiting the systemic risk potential.

US P&C Recoverables on Paid Losses Compared to Surplus and Assets



$14 Billion Reinsurance Recoverable on Paid Losses are the only amounts currently due. Reflects the illiquid nature of insurance and reinsurance obligations.

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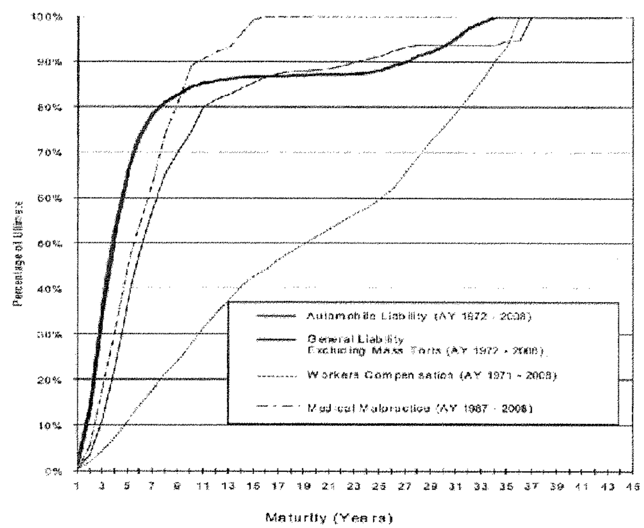
Time/Liquidity - Liability reinsurance losses emerge over many years.

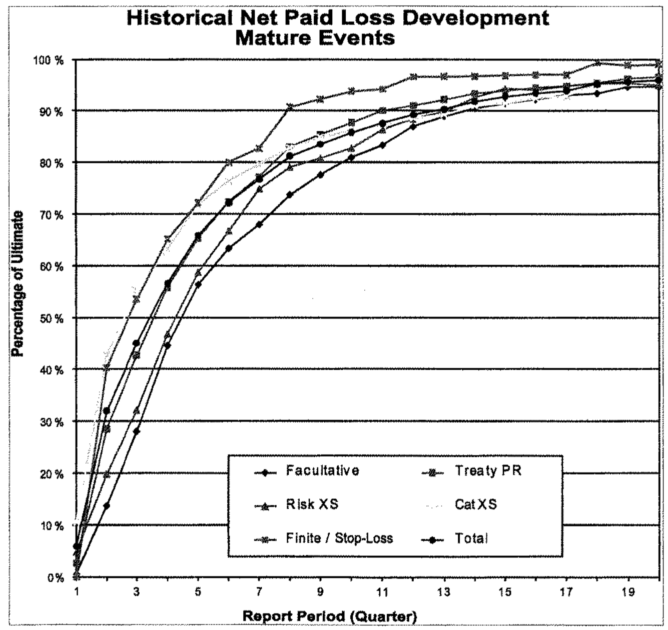
Historical Loss Development Paid Losses Excess Reinsurance



RAA Historical Loss Development Study, 2009 Edition

Time / Liquidity

Reinsured property catastrophe losses also emerge more slowly than might be expected.



 RAA Catastrophe Loss Development Study, 2010 Edition – Events through 2004

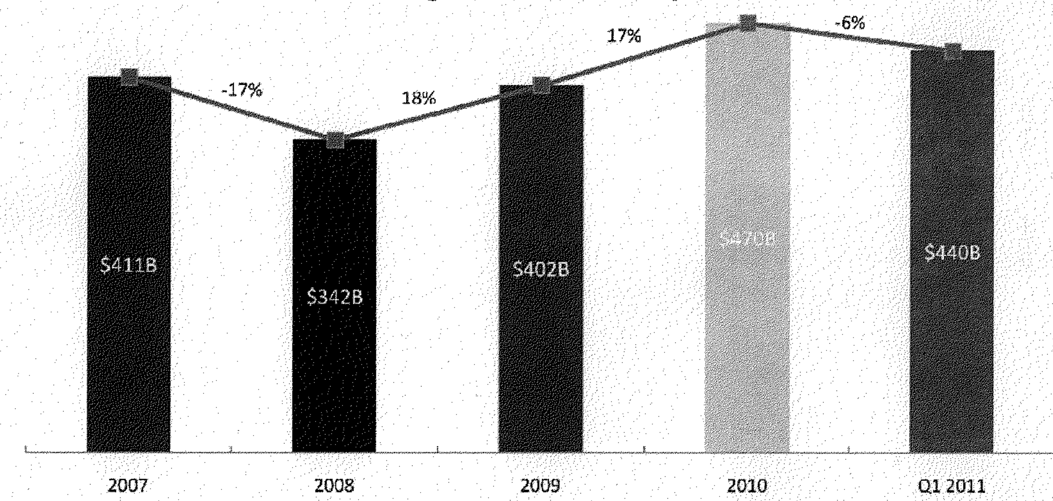
RAA

Assumptions Underlying A Global Reinsurance Stress Test Scenario

RAA

Reinsurer capital was minimally impacted by the financial crisis. It recovered quickly and remains adequate for demand.

Change in Reinsurer Capital



Source: Individual Company Reports, Aon Benfield Analytics

Economic losses are 5 to 20 times greater than reinsured losses.

The Range can be impacted by:

- type of reinsurance (XOL v. QS)
- type of peril (take-up rate/exclusions)
  - e.g. Earthquake/Flood
- location (insurance penetration)
  - e.g. developed v. developing economies
- level of government participation in the reinsurance market

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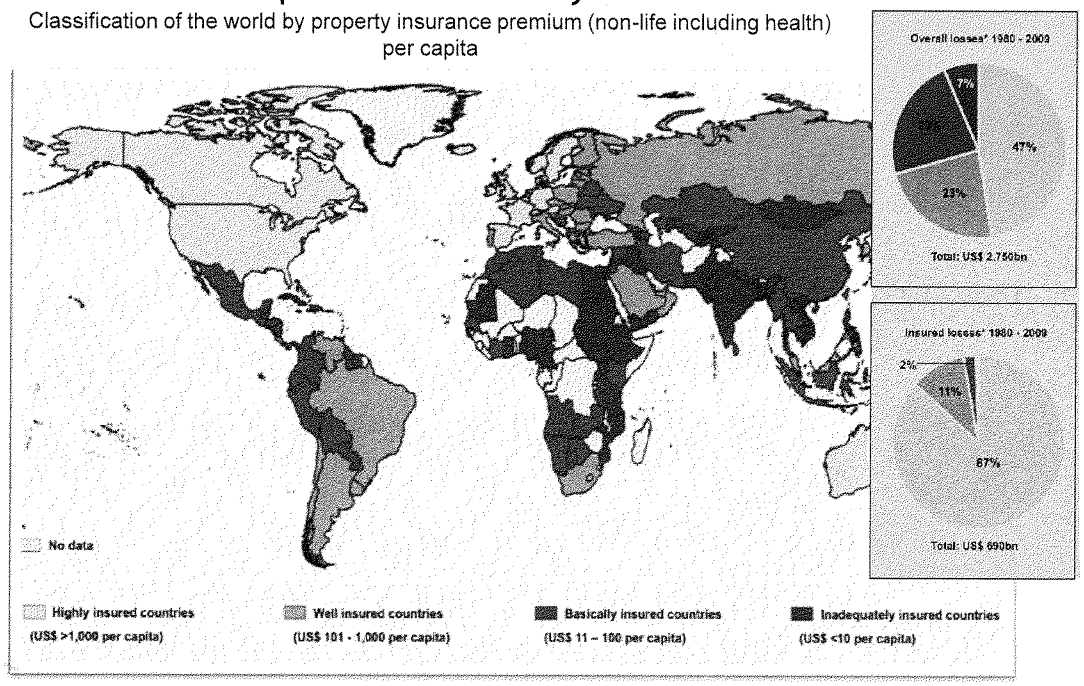
Natural Catastrophes in differently insured countries

Classification of the world by property insurance premium (non-life including health) per capita

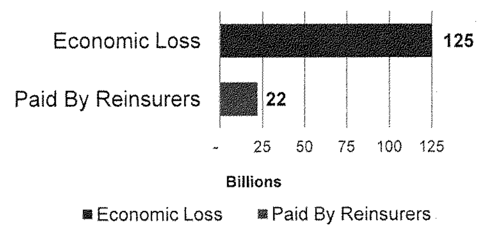


Source: MR NatCat*SERVICE* as at July 2010

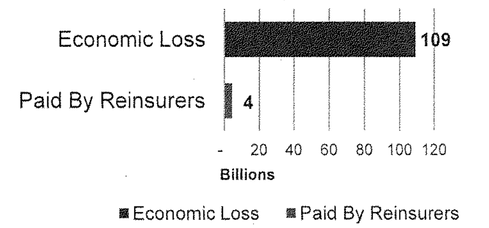
Economic Losses are 5 to 20 Times Greater than Reinsured Losses

Reinsurance is not nearly as significant a source of risk compared to uninsured loss.

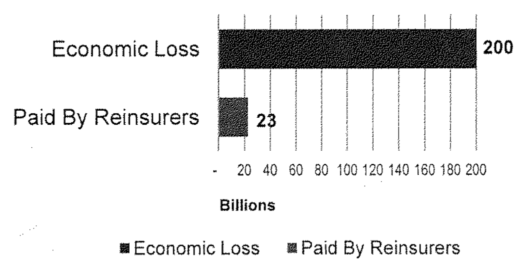
Hurricane Katrina



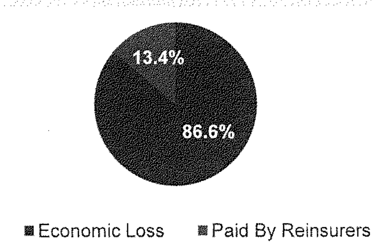
U.S. 1-in-250 Yr EQE



9/11/2001 Terrorist Attack



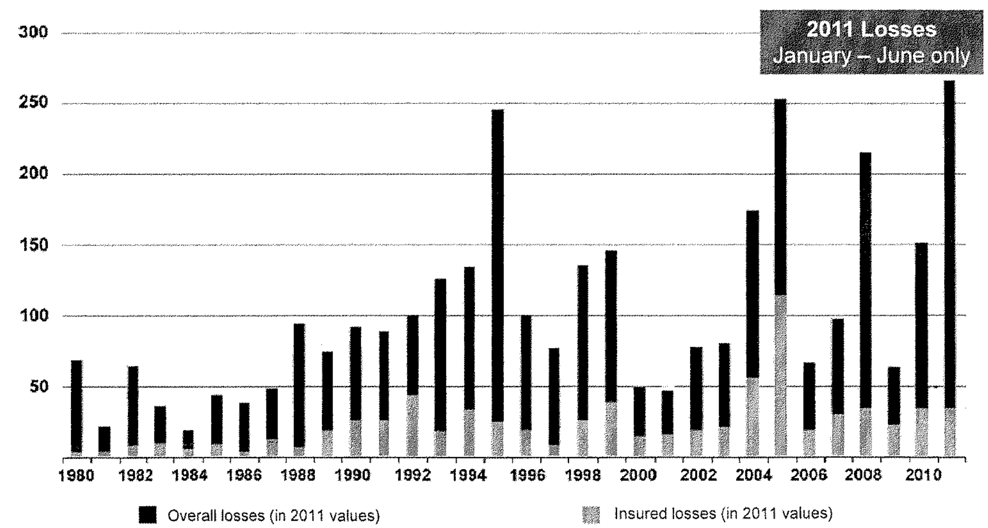
Average of Significant Historical Events



Worldwide Natural Disasters 1980 - 2011

Overall Economic versus Insured Losses

Insured losses are a small portion of economic losses: Reinsurance loss is an even smaller portion.



 Source: MR NatCat*SERVICE*

Stress Test Scenario: 100% Solvency Ratio

Creating an extreme scenario: What would it take to bring down a major reinsurer?

- To start with: let's focus on a leading global reinsurer to see **what amount of losses would be needed to reduce its capital base to 100% of the solvency ratio.** Let's use published data for Munich Re and Swiss Re (the global TOP2) and think of this **hypothetical reinsurer as a simple average of the two market leaders** (thus all numbers used in this example will be based on a simple average of the respective Munich Re and Swiss Re number).

- Taking into account an average 2009 solvency ratio of 253% for this hypothetical reinsurer and available capital of $33.7 bn., a fall to the 100% solvency ratio level (capital at $13.3 bn.) would imply a cumulated loss event in the magnitude of $~20.4 bn.

- This would imply a loss more than ten times the loss from Hurricane Katrina (~$1.9bn. for Munich Re and Swiss Re on average), the by far largest (re)insured loss event in history.

- Thus, it would take such an extremely large loss event (or equivalently, a series of very large loss events taking place within a short period of time) just to bring the level of capital to 100% of the solvency margin. One should therefore extend this stress scenario to the entire industry to see what level of economic loss would cause the whole reinsurance industry's capital to fall to a 100% solvency ratio level.

Solvency Ratio 253%	≡	Available Capital $33.7 bn
Solvency Ratio 100%	≡	Available Capital $13.3bn
$33.7bn - $13.3bn		**Hypothetical reinsurance loss must be ≥ $~20.4bn**

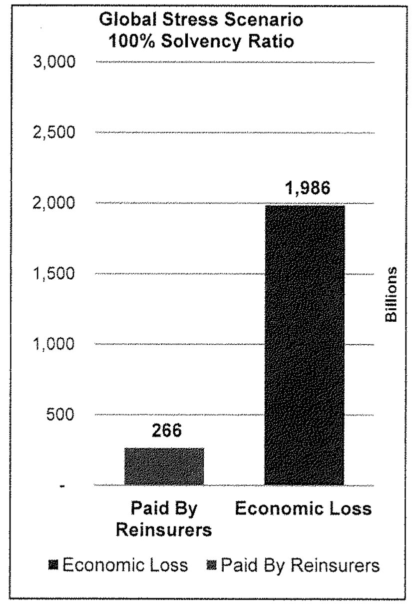
Hypothetical reinsurance loss equals more than **10-times Hurricane Katrina loss**

Such an extreme loss event would still only reduce capital to a 100% solvency ratio, **meaning that this hypothetical reinsurer remains a going concern and all claims are paid.**

Source: Munich Re, Swiss Re

Extreme scenario at 100% solvency ratio shows: Respective economic loss would by far exceed the reinsurance industry loss.

- Assuming similar solvency ratios[1] for the rest of the industry and using numbers on total industry capital[2], it would take a loss to the reinsurance industry of $~266.1 bn. to create such a scenario that reduces industry capital to a 100% solvency ratio level.
- In contrast to these already very large numbers, the estimated **total economic loss** from such a series of extreme events is likely to be close to **$1,986 bn.** (for comparison again: the economic loss from Hurricane Katrina was $~125 bn.).
- **All of the Great Natural Catastrophes that have occurred World-wide from 1950 – 2010 amount to $2,100 bn.** (adjusted to 2010 values), which is about the size of loss from a series of events occuring in a single year that would be needed to bring industry capital down to a100% solvency ratio
- **The respective total economic loss of this extreme scenario would by far exceed the reinsurance industry loss. Moreover at a 100% solvency ratio, the reinsurance industry would not see widespread default as the existing capital base and reserves would be sufficient to pay the claims.**



1) clearly a simplifying assumption, as solvency ratios differ between reinsurers; 2) taken from Aon Benfield's estimate that global reinsurance capital is $440 bn.

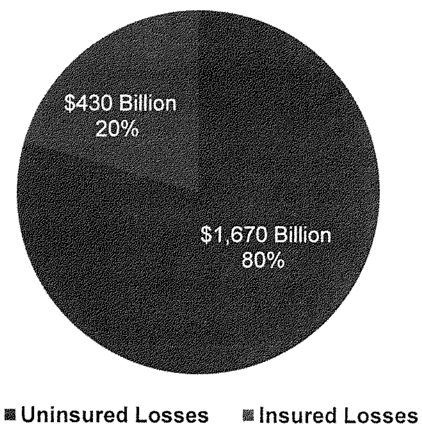
Source: RAA Analysis Based on Underlying Assumptions Provided by a Munich Re and Swiss Re Analysis

RAA

Great natural catastrophes worldwide 1950-2010

The total economic losses used in the global stress test are greater than all of the great natural catastrophes worldwide between 1950-2010.

Total Economic Loss of $2,100 Billion
(Adjusted to 2010 Values)



 Source: Munich Re Nat Cat SERVICE, As of January 2011

Stress Test Scenario: 40% Solvency Ratio

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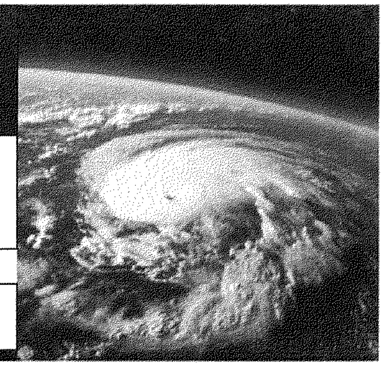
Extreme Stress Test Scenario Analysis



	Swiss Re / Munich Re Combined	Global Industry
	$ in Billions	
Solvency Ratio 253%	33.7	440.0
Solvency Ratio 100%	13.3	173.9
Solvency Ratio 40%	5.3	69.6
Implied Cuml. Loss @ 100%	20.4	266.1
Implied Cuml. Loss @ 40%	28.4	370.4

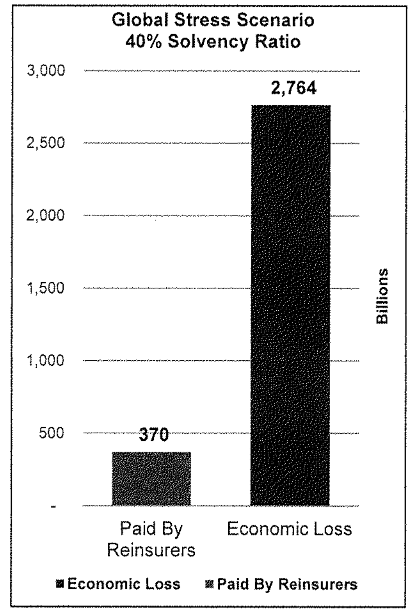
Economic Loss Scenarios Needed to Reduce Industry Capital to 100% of Solvency Ratio			Example Type of Events
	Global Re Loss	Global Economic Loss	
Reins Loss = 20% of Economic Loss	102.0	1,330.4	Hurricanes (U.S. /Developed Economies)
Reins Loss = 13.4% of Economic Loss	152.2	1,985.7	Mix of Global Events
Reins Loss = 5.5% of Economic Loss	370.8	4,837.9	Earthquake/Flood w/low take-up rate

Economic Loss Scenarios Needed to Reduce Industry Capital to 40% of Solvency Ratio			Example Type of Events
Reins Loss = 20% of Economic Loss	142.0	1,852.2	Hurricanes (U.S. /Developed Economies)
Reins Loss = 13.4% of Economic Loss	211.9	2,764.4	Mix of Global Events
Reins Loss = 5.5% of Economic Loss	516.2	6,735.2	Earthquake/Flood w/low take-up rate

Extreme scenario at 40% solvency ratio shows: Respective economic loss would by far exceed the reinsurance industry loss.

- Assuming similar solvency ratios[1] for the rest of the industry and using numbers on total industry capital[2], it would take a loss to the reinsurance industry of $~370.4 bn.) to create such a scenario.
- In contrast to these already very large numbers, the estimated **total economic loss** from such a series of extreme events is likely to be close to **$2,764 bn.**
- For comparison, a loss of $2,800 bn. equates to nearly twice the amount of economic losses from all hurricanes and earthquakes that occurred in the U.S. between 1900 and 2005 based on normalized loss statistics as published in studies by Dr. Roger Pielke—University of Colorado.

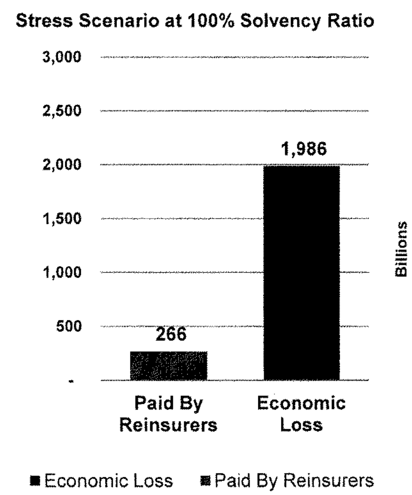
- **The respective total economic loss of this extreme scenario would by far exceed the reinsurance industry loss. Moreover the reinsurance industry's loss would largely be paid given their present $440 bn. in capital.**

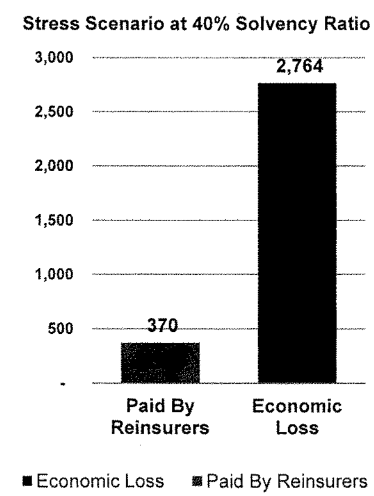


1) clearly a simplifying assumption, as solvency ratios differ between reinsurers; 2) taken from Aon Benfield's estimate that global reinsurance capital is $440 bn.

Source: RAA Analysis Based on Underlying Assumptions Provided by a Munich Re and Swiss Re Analysis

Economic losses (not reinsurance losses) are the true source of systemic risk following extreme loss events.



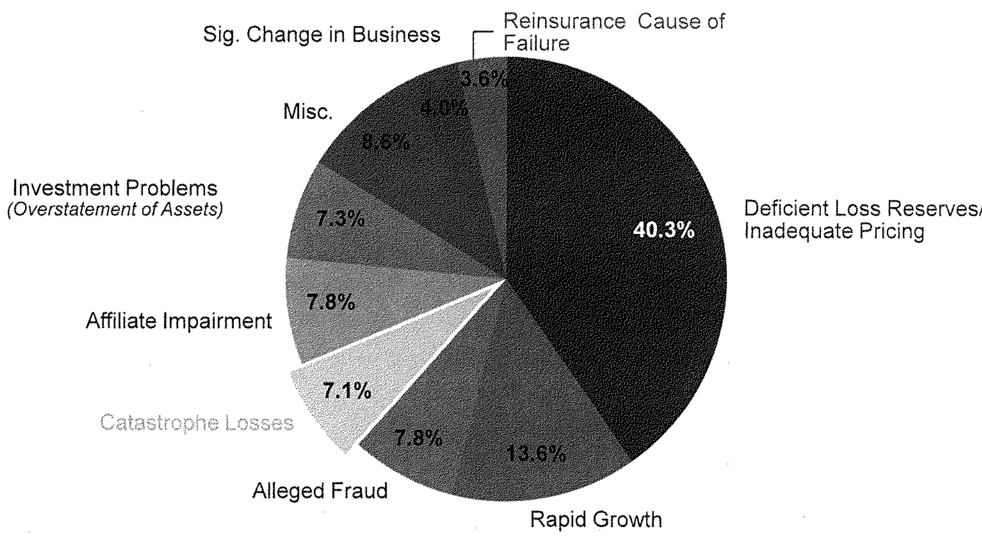


U.S. Financial Institutions Impairment History and Implications for P&C Reinsurance Systemic Risk

RAA

Insurance impairments attributed to reinsurance as the cause of failure are historically insignificant.

Reasons for US P/C Insurer Impairments, 1969–2010



Source: A.M. Best: *1969-2010 Impairment Review*, Special Report, April 2011.

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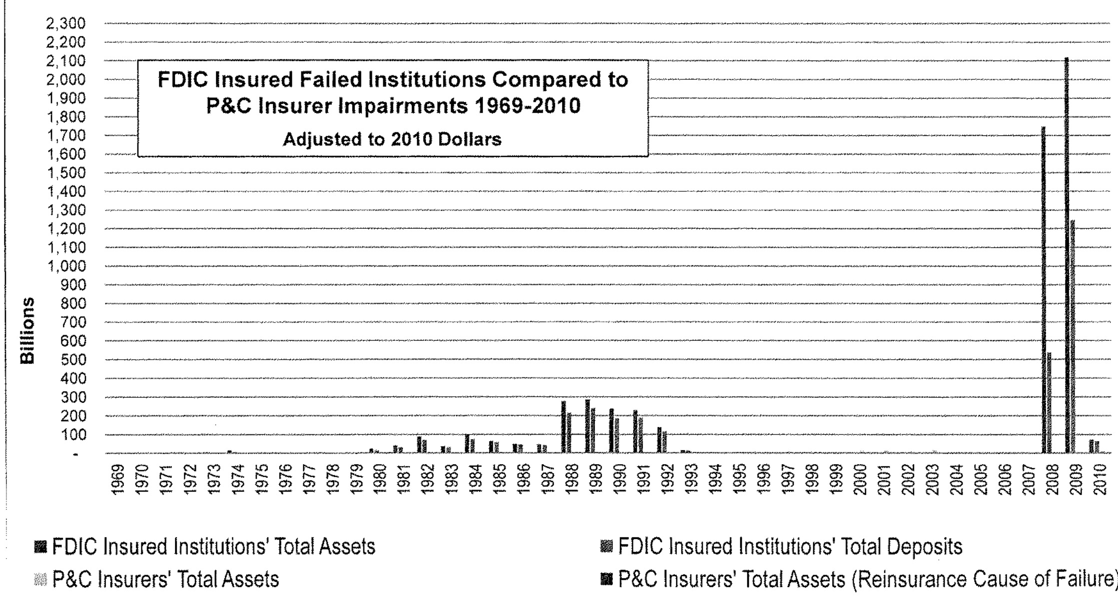
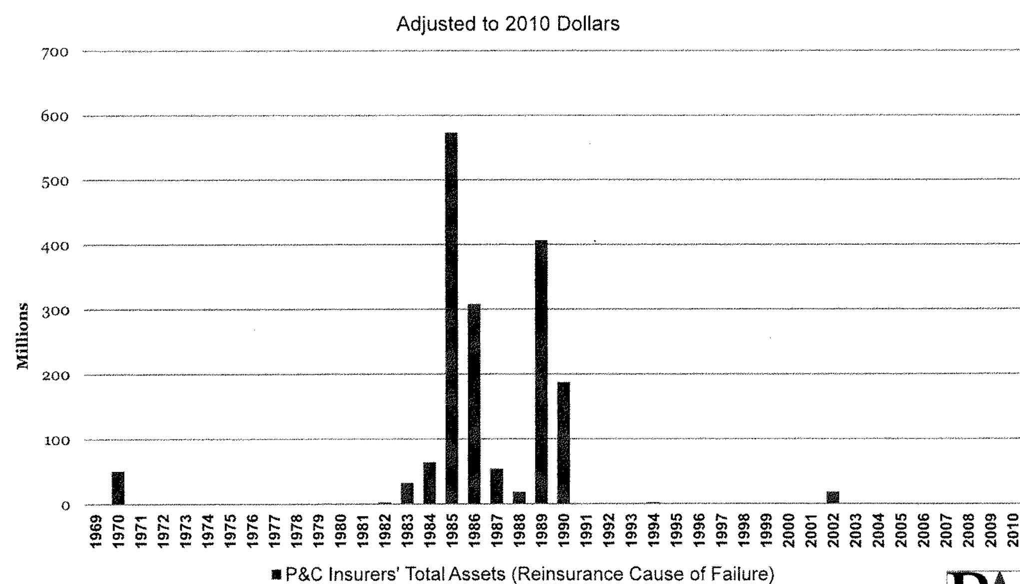
Insurance impairments are insignificant compared to bank impairments in past crises and over several economic cycles.



33 Source: A.M. Best: *1969-2010 Impairment Review*, Special Report, April 2011; FDIC.

Insurance impairments attributed to reinsurance failure are insignificant over the same period.

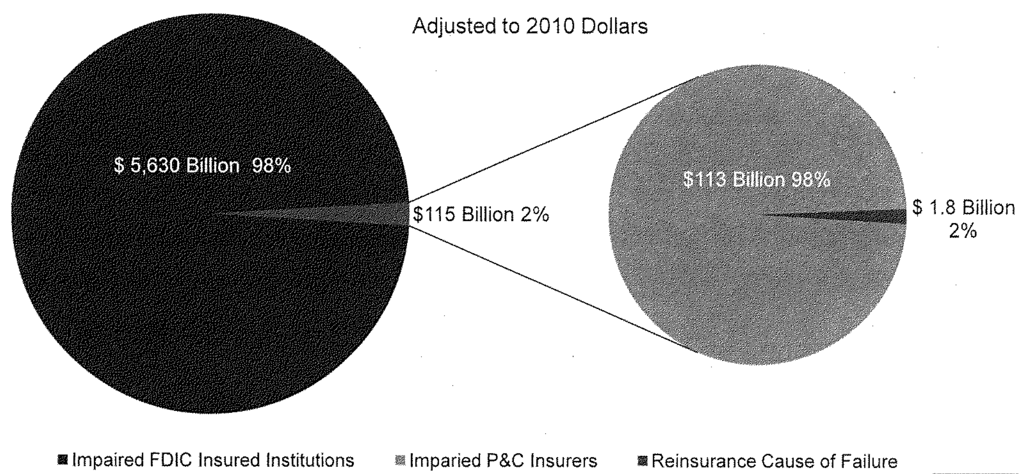


Source: A.M. Best: *1969-2010 Impairment Review*, Special Report, April 2011.

Reinsurance failure is not a significant cause of insurance impairment and pales in comparison to the systemic risk in the banking industry. – View 1

Total Assets of FDIC Insured Failed Institutions Compared to P&C Insurer Impairments 1969-2010

Adjusted to 2010 Dollars



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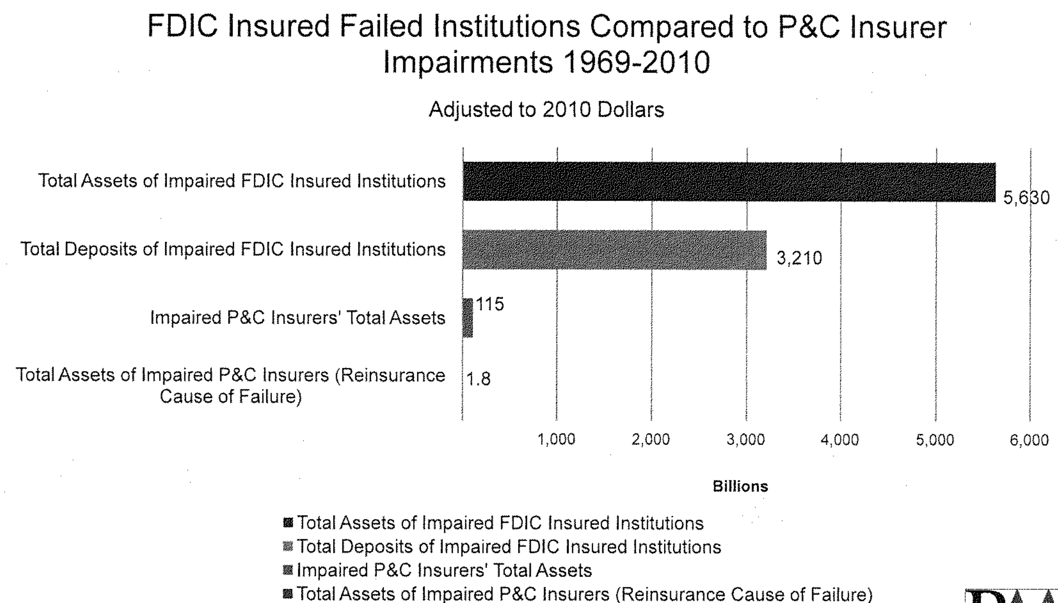
Reinsurance failure is not a significant cause of insurance impairment and pales in comparison to the systemic risk in the banking industry. – View 2



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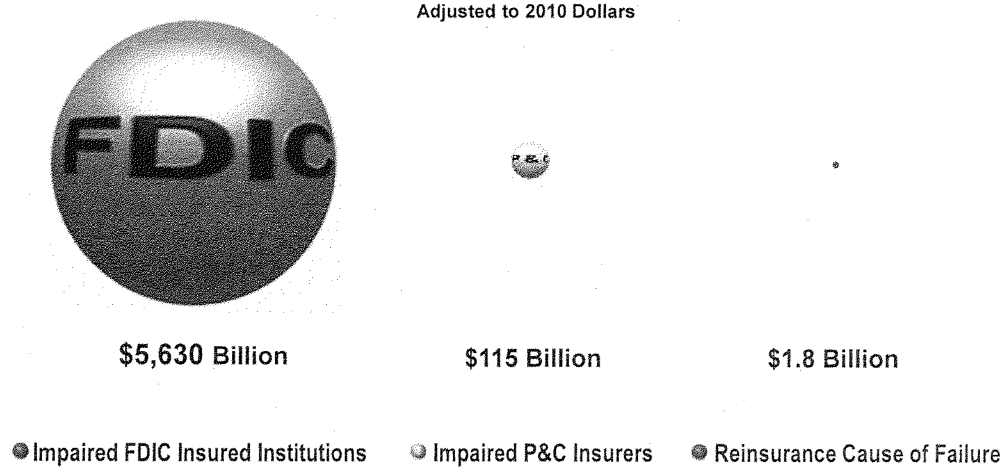
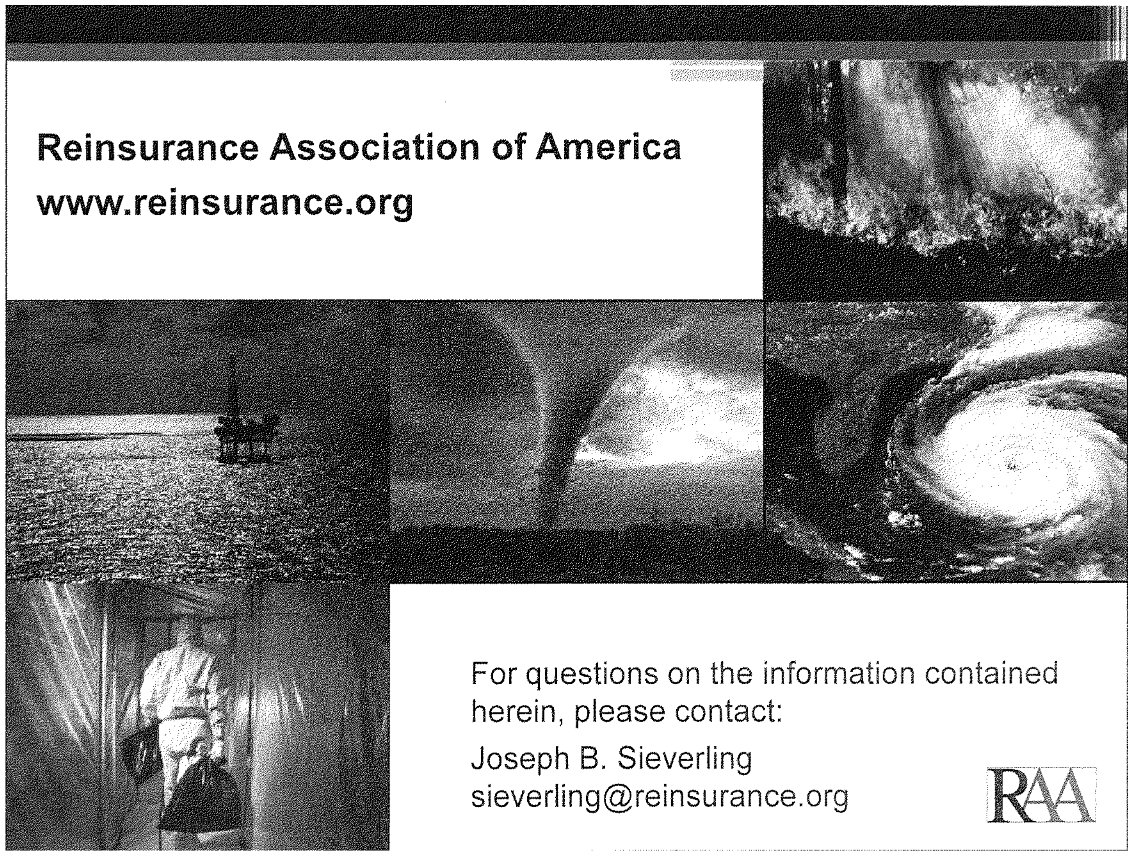
Reinsurance failure is not a significant cause of insurance impairment and pales in comparison to the systemic risk in the banking industry. – View 3

Total Assets of FDIC Insured Failed Institutions Compared to P&C Insurer Impairments 1969-2010

Adjusted to 2010 Dollars




Reinsurance Association of America
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Joseph B. Sieverling
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RAA

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Insurance, Housing and
Community Opportunity
Committee on Financial Services
United States House of Representatives

Regarding:
"Insurance Oversight: Policy Implications for U.S. Consumers,
Businesses and Jobs"

Thursday, July 28, 2011

Susan E. Voss
Commissioner, Iowa Insurance Division
As President of the National Association of Insurance Commissioners

Introduction

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today. My name is Susan Voss, and I am Commissioner of Insurance for the State of Iowa. I am here as President of the National Association of Insurance Commissioners (NAIC), and I present this testimony on behalf of that organization. Specifically, I am here to provide an overview of recent insurance regulatory activities, including the NAIC's continued response to the recent financial crisis.

The past few years have seen an understandable flurry of activity in the financial regulatory arena. Lawmakers and regulators here and abroad have engaged in the monumental task of enhancing authorities to better monitor and police financial markets, curtail activities that pose risks to the broader financial system, and address "too big to fail" financial institutions. In addition to interacting with our federal and state counterparts charged with implementing reform for banking and securities entities, insurance regulators have recognized that regulatory enhancements can and should be made to ensure that the positive track record of state-based insurance regulation continues in an increasingly complex and global marketplace. I am happy to be before you today to describe various ways in which the states have stepped up to these challenges.

My testimony today will focus on three broad areas. First, I will explain how state insurance regulators are working with federal legislators and regulators on the federal activities undertaken in response to the financial crisis; namely, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Next, I will discuss separate activities that the NAIC has undertaken in response to that crisis. Finally, I will highlight some processes that we are engaged in with an eye toward the future of insurance regulation around the world.

Responding to the Dodd-Frank Act

At its core, the Dodd-Frank Act acknowledges the differences between insurance and other financial products, as well as the strength of the state-based insurance regulatory system. Title II of that statute authorizes the Federal Deposit Insurance Corporation (FDIC) to resolve systemically risky companies that are in financial distress, but requires that insurance companies be resolved pursuant to state law. Title V creates a Federal Insurance Office (FIO) to provide the federal government with information regarding insurance and to negotiate certain international agreements, but preserves the states' authority to regulate and supervise insurance. The Act authorizes implementation of a Volcker Rule that seeks to curb proprietary trading at banks and non-bank systemically important financial institutions (SIFIs), but provides an exception for insurance company investments for general accounts. Title X creates a bureau of consumer financial protection, but excludes insurance from its jurisdiction and ensures that the power of protecting insurance policyholders remains with the states.

To date, the state insurance regulators through the NAIC have provided input on four main areas of Dodd-Frank implementation: 1) the Financial Stability Oversight Council (FSOC); 2) Orderly Resolution; 3) Derivatives Regulation; and 4) Surplus Lines and Reinsurance. We are also monitoring three other areas very closely: 1) the implementation of the Volcker Rule; 2) the Federal Reserve's new authorities to oversee SIFIs and Thrift Holding Companies; and 3) the development of the Federal Insurance Office.

<u>Financial Stability Oversight Council</u>

The state regulators are represented on FSOC through John Huff, who was appointed through the NAIC to serve as a non-voting member on the panel. As you know, FSOC has the authority to designate non-bank financial institutions, including insurance companies, for heightened supervision by the Federal Reserve. Through Director Huff, the NAIC has been working to educate all FSOC members on the fact that core insurance activities are different from other types of financial activities and don't pose systemic risk. At the same time, we also recognize that unregulated affiliates or other large scale non-insurance related activities could pose such risks and might create a basis for such designation.

This effort has been complicated by the scarcity of insurance representation on the Council up until very recently. Although FSOC is required to consult with the functional regulators of any institutions being considered for systemic oversight, at that point in the process critical decisions about insurance will have already been made. There is ongoing work to develop appropriate criteria, and judgments about the insurance industry are being made that would benefit from more input from insurance regulators. The NAIC remains hopeful that this challenge will improve with the addition of one of our former colleagues, Mike McRaith, as FIO Director, as well as with the addition of recently-nominated Roy Woodall as the insurance expert and only voting member on insurance issues on FSOC. However, it is important to note that Director Huff will remain the sole active insurance regulator on FSOC, and his need to consult with his fellow insurance regulators on confidential issues impacting insurance remains a concern for the state regulators.

Orderly Resolution

The NAIC has been actively engaged with the FDIC on its new orderly resolution authorities under Title II. The NAIC's Dodd-Frank Receivership Implementation Working Group is composed of insurance receivership regulatory experts and is charged with examining the impact this new regime may have on existing state insurance receivership processes. As part of this effort, we are considering a new draft chapter to be added to the NAIC Receivers' Handbook: "Procedures for Prompt Initiation of State Receivership under Dodd-Frank." It is believed that this addition will establish procedures at the state level to ensure the state receivership mechanism will respond effectively to a receivership arising from a systemic failure.

The Dodd-Frank Receivership Implementation Working Group also assists the NAIC in responding to specific rules proposed under Title II that could have implications for insurance; actions that afford us the opportunity to strengthen our already positive relationship with the FDIC. We have commented on proposals that could potentially enable the FDIC to take a lien on insurance company assets if that agency had to exercise its authority with respect to the company's non-insurance affiliate or parent. Regulators have also requested that the FDIC allow for the resolution of any mutual insurance holding companies pursuant to state insurance receivership law, even though the statute is murky in this regard. While we hope there is never an occasion where the FDIC has to exercise its authorities on a company with insurance operations, our good working relationship with this agency will be critical to ensuring that policyholders are protected during such an event.

Derivatives

The NAIC has actively responded to rules proposed by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) regarding their new authorities to regulate the over-the-counter derivatives market. Our position on this matter has been governed by two guiding principles: 1) any rules issued by the SEC and CFTC should not conflict with the insurance regulatory regime; and 2) such rules should not create an unlevel playing field between insurers and non-insurers.

The NAIC has asked the SEC and CFTC to further refine its rules regarding the definition of "swap dealer" to ensure that it does not inadvertently capture insurers absent any indication that they are truly engaging in traditional dealer-like activities. We've also called for changes to the definition of "major swap participant" so that it reflects the differences between insurers and other financial entities, including the fact that insurers use derivatives primarily for hedging against commercial risks.

A very important recently proposed rule involves the additional definitions of swaps and security-based swaps; under Dodd-Frank, these items could conceivably include certain insurance products though we do not believe this was Congress' intent. Since enactment of the statute, the NAIC has sought clarification from the SEC and CFTC that these definitions do not include insurance products sold by a regulated insurance company. We believe that we have made significant progress with the agencies in this regard, but we are of the view that certain changes still need to be made to exclude all regulated insurance products. We recently provided comments to the SEC and CFTC and hope to work with them as they continue to refine the rule.

Surplus Lines and Reinsurance

The Dodd-Frank Act also included provisions relating to the regulation of nonadmitted, or "surplus lines," insurance. Most of those provisions became effective just days ago and states continue efforts to implement changes consistent with the law while ensuring equitable distribution of premium taxes. The risk of losing valuable surplus lines premium tax revenues to the "home state" of a policyholder on multi-state risk is a powerful incentive as state legislatures meet to consider this issue. Regulators agree it is imperative to preserve the ability of states to receive surplus lines premium taxes to the same extent we do today; that is, regulators want to ensure states continue to receive taxes based on the risk or exposure located in a given state.

In August of last year, the NAIC established a task force under its executive committee to examine the various structures for implementing a state-based solution to these new surplus lines provisions. After considering a formal interstate compact approach, the task force opted to develop an interstate agreement, presently known as the Nonadmitted Insurance Multi-State Agreement (NIMA), which states could enter into through enabling legislation and other statutory changes.

NIMA does not transfer broad supervisory authority to a single compacting entity, but it does provide for a single point of tax filing – the main concern of surplus lines brokers. As of the one-year anniversary of the enactment of the Dodd-Frank Act, ten states and Puerto Rico had joined NIMA, but other states have sought alternative solutions to the challenges brought on by the new law. A similar number of states have passed a compact approach to comply with Dodd-Frank, while other states have given their insurance commissioners the authority to join a solution that is in the best interest of their respective states. We expect that over time, given state legislative calendars and other issues, states may gravitate toward a solution that represents the largest percentage of premium taxes to help preserve their level of income. In the meantime, brokers' lives are simplified in that they only have to file tax with the "home state," and there are simplified eligibility standards. Whichever solution is chosen, it is clear that a significant number of states have acted quickly in the 330 days they were given before their systems were preempted by Dodd-Frank.

The same title of the Dodd-Frank Act also made significant changes in the area of reinsurance, which the NAIC coordinates and monitors through the Reinsurance Task Force of its Financial Condition (E) Committee. At present, the task force continues its work to implement a reinsurance regulatory modernization framework that is intended to facilitate cross-border reinsurance transactions and enhance competition within the U.S. market, while ensuring that U.S. insurers and policyholders are adequately protected against the risk of insolvency. The task force is considering amendments to the applicable NAIC state model law and regulation, and plans to implement these reforms prior to year-end. These reforms will put in place a method by which states may relax collateral requirements for foreign reinsurers if appropriate.

"Volcker Rule" and New Federal Reserve Authorities

The Volcker Rule prohibits insured depository institutions and their affiliates from engaging in proprietary trading, and also requires additional capital requirements and quantitative limits for non-bank financial institutions designated by FSOC for heightened supervision. The Dodd-Frank Act provides that the implementation of the Volcker Rule should "accommodate the business of insurance," and the NAIC is closely monitoring the implementation of this rule to ensure that the agencies do so.

In January, FSOC issued a study regarding the implementation of the Volcker Rule by the federal financial agencies; on insurance, that report is generally consistent with the wording of Dodd-Frank. The study recommended that insurance investments for the general account should be permitted even if they otherwise might be considered "proprietary trading" under the statute, provided that such investments are compliant with state investment laws and such investments do not threaten an affiliated bank or the financial stability of the United States. However, the study also recommended that the agencies consider, among other items:

1. The timing and approach to the assessment of insurance company investment laws in determining whether such laws adequately protect a given institution or the financial stability of the United States;
2. How to handle investments made by foreign insurance companies; and
3. Whether separate account investments should be treated as being made on behalf of customers (another permitted activity under the Volcker Rule).

The NAIC is waiting to see how such issues and others are resolved in the proposed rule before determining an appropriate response.

In addition, the Federal Reserve will regulate any SIFIs designated by FSOC and will be the consolidated regulator for any thrift holding company groups. While it is still unclear how the Fed will regulate such companies, we are monitoring work done in this area to see whether such activity will have any impact on the states' risk-based capital system and any other aspects of the insurance regulatory regime. We have had a good relationship with the Federal Reserve to date, and look forward to working with them on this issue.

Federal Insurance Office

The final area of the Dodd-Frank Act that I would like to discuss today is the Federal Insurance Office. FIO will impact all lines of insurance except health, long-term care (aside from those policies paired with life or annuity components), and crop insurance. However, it does not possess general supervisory or regulatory authority over the business of insurance.

FIO will have the authority to work with the U.S. Treasury Department and the Office of the U.S. Trade Representative (USTR) on negotiating international "covered agreements" for the recognition of prudential measures governing the business of insurance and reinsurance. Such agreements must achieve a level of protection for insurance consumers that is substantially equivalent to the level of protection achieved under state regulation. FIO is authorized to preempt state laws once such covered agreements are completed – but only to the extent that a state law treats a non-U.S. insurer less favorably than a U.S. insurer. Furthermore, FIO is prohibited from preempting state laws and regulations governing solvency and consumer protection.

The FIO Director will also advise the Treasury Secretary on major domestic and international insurance policy issues. To that end, the NAIC supported the office's membership to the International Association of Insurance Supervisors (IAIS). FIO will also be authorized to collect information on insurance at the federal level but is required to get this information from the states and other sources, such as the NAIC.

The Dodd-Frank Act requires FIO to issue a report on insurance regulation by January 2011. The report will include legislative recommendations and look at the potential for federal regulation of insurance. We hope the report will be honest and factual, but we continue to believe there is an inherent conflict in an office of the Treasury Department studying ways to further empower itself. While the national state-based system of insurance regulation has successfully protected the interest of consumers for decades, state regulators recognize that, like any regulatory system, it is not perfect and we are open to hearing any suggestions FIO may have for improvements. To date, the NAIC has had a good relationship with FIO, and we look forward to continuing that relationship going forward and working with our friend and former colleague, Mike McRaith.

Independent Insurance Regulatory Developments

Representatives from the NAIC have frequently testified before the House Financial Services Committee on our continuing efforts to improve the state-based system of regulation; this work was underway well before the financial crisis. The checks and balances inherent to our multi-state oversight are important to ensuring robust regulations in a variety of dimensions and from a variety of perspectives. In that vein, state regulators have worked through the NAIC to enrich our regime and ensure that insurance consumers will continue to be afforded the highest level of protection. Regulators have made enhancements to group supervision, lessened reliance on credit rating agencies, examined methods to improve solvency protection, and played a key role in activities on the international level.

Enhancements to Group Supervision

The financial crisis certainly underscored a need for state insurance regulators to enhance and improve group supervision. From our experiences in dealing with situations where an insurance company was either held by or was an affiliate of a business governed by another regulator agency, we learned that it is not enough to focus solely on transactions with insurance companies; we need to look through our "windows" and understand the contagions that could impact insurers. However, we must still have an appreciation of the "walls" in place when examining material exchanges between the insurers and other parts of the group – our ability to ring fence insurers to protect the assets supporting policyholder obligations.

In December of last year, the NAIC adopted revisions to the *Insurance Holding Company System Model Act* and the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions*. These revisions are intended to provide regulators the ability to better assess the enterprise risk within a holding company system and its impact on an insurer within the group. Ultimately, this enhanced "windows and walls" approach should provide greater and much needed breadth and scope to solvency regulation while maintaining the highest level of policyholder protection.

The concepts addressed in the enhanced "windows and walls" approach provide for a number of improvements. We have expanded the disclosure requirements to any entity within the insurance holding company system that could pose reputational or financial risk to the insurer and clarified that the insurance regulator has the right to access information on any entity of a holding company system when desired. We have included official recognition of regulators' participation in "supervisory colleges" for groups with international activities and established the funding mechanism for such participation. We have made a number of enhancements in corporate governance, including introducing high level responsibilities of the Board of Directors and senior management. Finally, additional requirements have been added to the terms and conditions of affiliated cost-sharing and management services agreements in order to assist regulators in determining whether transactions are fair and equitable to insurers.

Reliance on Credit Rating Agencies

The financial crisis also revealed that insurance market participants and regulators overly relied on credit ratings issued by the Nationally Recognized Statistical Rating Organizations (NRSROs). In an effort to reduce our reliance on these rating agencies, the NAIC acted to more closely align the capital requirements for residential mortgage-backed securities (RMBS) and for commercial mortgage-backed securities (CMBS) with appropriate economic expectations. These two asset classes represent over $300 billion in carrying value of invested assets for the U.S. insurance industry.

The NAIC developed alternative methodologies for evaluating CMBS and RMBS investments, and the new process results in a more accurate reflection of the risk of loss for each specific insurer that is then mapped to a risk-based capital factor. At the conclusion of our most recent year of effort in this regard, the NAIC made available projected expected losses on a list of approximately 19,500 residential mortgage-backed securities and 5,200 commercial mortgage-backed securities to insurers, the Federal Reserve and other federal agencies. While the NAIC continues to use the NRSROs for other asset classes, our Valuation of Securities Task Force, as well as our Rating Agency Working Group, are monitoring these other asset classes to determine whether continued reliance is appropriate.

Additional Transparency to Securities Lending

Perhaps our greatest single source of concern for insurance regulators during the financial crisis was over securities lending activities by AIG; work that was separate from the non-insurance problems at the AIG Financial Products Division overseas. U.S. insurance regulators had discovered the change in AIG's management of the securities lending program in 2007 during a regular financial examination, and immediately began working with the company to wind down the activity and provide additional public disclosure of the structure and risks facing the program.

In the time since the AIG Securities Lending discovery, insurance regulators have taken a number of actions to ensure transparency in any such activities at insurance companies in the future. We improved the guidance for such activity in 2008, as well as annual financial statement disclosure requirements in order to obtain summary information on the duration of when related collateral is required to be returned to the counterparty. This allows regulators to more readily identify if an insurer's securities lending program could cause excessive liquidity strains under stressed scenarios. Furthermore, the NAIC adopted a new Schedule DL in 2010 to strengthen transparency in securities lending agreements utilized by insurers by requiring detailed disclosure of the program's collateral instruments.

Looking Forward: The Future of Insurance Regulation

Solvency Modernization Initiative

In June 2008, state insurance regulators began the Solvency Modernization Initiative; a critical self-examination of the U.S. insurance solvency system. While this system had helped protect the relative stability of the insurance sector during the financial crisis, the success of the past does not necessarily prepare us for the challenges of the future. Under SMI, we are examining international developments regarding insurance supervision, banking supervision, and international accounting standards in order to consider their potential use in U.S. insurance regulation. We believe that, ultimately, this open and transparent process will drive changes to our overall regulatory system. We must learn from international developments and collaborate where appropriate, but we cannot abdicate our responsibility for U.S. insurance consumers and companies.

The SMI project is focused on several major areas, such as outlining high-level corporate governance principles and determining the appropriate methodology to evaluate adherence with such principles. We are also reviewing IAIS principles and standards related to corporate governance as part of this effort. From this work, we hope to identify future initiatives to improve our regulatory solvency system.

Furthermore, we are also considering ways in which to improve risk-based capital standards in order to ensure they adequately capture the appropriate risks to U.S. insurers. In the area of statutory accounting and financial reporting, we remain committed to implementing a principles-based methodology to reserving requirements. Finally, we continue to maintain statutory accounting for regulatory purposes and consider what the impacts international accounting standards may have here. Though implementation of all of these changes will take time, we anticipate that all major policy decisions in SMI will be adopted by December of next year.

International Efforts

Of course, insurance markets have evolved over the years to become increasingly global, interconnected, and convergent, and this trend will undoubtedly continue in the years to come. Insurance regulators around the world have found that it is vital to constantly improve their level of cooperation, coordination and collaboration.

The NAIC is devoting significant resources and energy to international standard setting. In particular, we are actively working on revisions of the IAIS Insurance Core Principles (ICPs), which form the basis for the International Monetary Fund's Financial Sector Assessment Program (FSAP). State insurance regulators are also advocating enhanced coordination through supervisory colleges and through the new Supervisory Forum, which we chair at the IAIS. The objective of the Supervisory Forum is to strengthen the effectiveness of insurance supervision and to foster convergence of supervisory practices through the exchange of real-world experiences. In some respects, this initiative is modeled after the multi-jurisdictional coordination framework that exists in the United States.

The NAIC and the state regulators also welcome the objectives of the IAIS's Common Framework for the Supervision of Internationally Active Insurance Groups, or ComFrame, and are participating in its development process. This project aims to make group-wide supervision of internationally active insurance groups more effective, to foster cooperation and coordination among supervisors around the world and to close regulatory gaps. The ultimate role of ComFrame is under discussion and will continue to develop; however, the intent is given by its name – a common framework – one that lays out how supervisors around the globe can work together to supervise internationally active insurance groups. ComFrame should neither be a platform for pushing a global capital standard for insurance, nor create prescriptive ways to promote a particular means for solvency standards, nor create additional layers of regulation. If done right, ComFrame has the potential to create a multijurisdictional approach to supervision that emphasizes robust oversight and cooperation while maintaining the proper balance between home and host jurisdictions.

In addition to these activities, U.S. state insurance regulators continue to participate in supervisory colleges for insurance-related entities around the world. As NAIC President, I participate in the Insurance and Private Pensions Committee (IPPC) of the Organization for Economic Cooperation and Development (OECD). Finally, the NAIC serves as technical experts to USTR officials regarding multi-lateral trade agreements through the World Trade Organization, including the General Agreement on Trade in Services and regional and bilateral trade negotiations.

Notwithstanding these international developments and their increasing impact on NAIC and state regulation, as we talk about international convergence, we must keep in mind that there are different regulatory systems and approaches around the globe, so convergence must be a discussion about arriving at common outcomes and not necessarily universal standards or structures. An area where this is particularly important is in looking at Solvency II in Europe and their equivalency process. U.S. state insurance regulators support Europe's efforts to modernize their solvency regime through the Solvency II project. While we intend to monitor the development of Solvency II and participate in ongoing discussions with our foreign counterparts, we do not intend to adopt Solvency II. However, there may be elements of Solvency II that we can learn from and consider incorporating into our system as appropriate, which is why it has been examined as part of our SMI process.

Solvency II looks to determine if other countries, including the U.S., offer "equivalent" levels of regulation compared to what it envisions. The U.S. has a strong system of insurance solvency supervision that helped the world's largest insurance market weather the worst financial crisis in decades. While we have a different legal and regulatory structure here in the U.S., we believe our system is at least equivalent to Solvency II on an outcomes basis. We therefore have been urging Europe to view equivalence as an outcomes-focused process and find the U.S. equivalent so as to avoid putting U.S. or European insurers at a competitive disadvantage.

Imposing jurisdictional or regional concepts unilaterally is counterproductive, but clearly all regulators have a vested interest in harmonizing our systems where appropriate in order to seek a more stable and competitive marketplace for companies and consumers. In my view, global convergence should heavily focus on information sharing, and should include mechanisms for peer review. Again, the key to addressing international insurance issues is to improve coordination, cooperation and communication among supervisors.

Conclusion

In conclusion, insurance oversight in the U.S. is strong and continues to improve. Following the financial crisis that had such devastating impacts to other financial sectors, insurance regulators have taken steps to address an evolving landscape and ensure continued protection of the American consumer. I think that after review, you will agree that states have made great strides in developing tools that can be leveraged to realize the efficiencies necessary for a competitive environment, while preserving states' front-line strength of solvency regulation and consumer protection. Thank you for this opportunity to testify, and I look forward to your questions.

**WRITTEN STATEMENT OF THE
NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL)**

**BEFORE THE SUBCOMMITTEE ON
INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
U.S. HOUSE OF REPRESENTATIVES**

HEARING ON
***"INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR
U.S. CONSUMERS, BUSINESSES AND JOBS"***

JULY 28, 2011

**THE HONORABLE GREG WREN
ALABAMA HOUSE OF REPRESENTATIVES
NCOIL TREASURER
IMMEDIATE PAST CHAIR, NCOIL STATE-FEDERAL
RELATIONS COMMITTEE**

Good afternoon Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee. Thank you for inviting me to testify before the Subcommittee on behalf of the National Conference of Insurance Legislators (NCOIL) on the very important subject of insurance oversight. My name is Greg Wren. I am an Alabama State Representative and I serve as Treasurer of NCOIL.

I am pleased to be here today to discuss with you our shared concern—that of the proper oversight of the insurance market in the best interest of all involved. Like you, NCOIL wants to make sure that the insurance marketplace works effectively and efficiently to promote better products, satisfied consumers, and healthy and thriving businesses.

NCOIL supports and has worked for modernization and uniformity in the states where and when it is needed. We—as state legislators with a sole focus on sound insurance public policy—believe that the states have the tools to promote and facilitate that modernization.

NCOIL appreciates that the Committee has acknowledged the many assets of state regulation and has not sought to preempt our authority to regulate our unique state markets and to protect our insurance consumers. We are optimistic that the newly created Federal Insurance Office and other recently formed agencies will also respect the authority and strength of the state system—strength that was evidenced during the recent financial crisis.

We also believe that proposals such as an optional or mandatory federal charter would only serve to undercut the successful state system now in place.

NCOIL is working—and will continue to work—with our state regulators, consumer advocates and industry to strengthen and enhance regulation in key areas that are in need of reform. NCOIL collaborated with NAIC and NCSL to develop the successful Interstate Insurance Product Regulation Compact (IIPRC)—a speed-to-market vehicle for life insurance products now in force in 41 jurisdictions. NCOIL has worked closely with the NAIC to simplify agent licensing and make it easier for a licensed agent to do business in another state. NCOIL continues to work for better market conduct regulation and has pushed our regulator colleagues to modernize exam procedures to free companies from duplicative and costly exams by regulators.

I would like to discuss in more depth NCOIL's most recent modernization effort—to streamline surplus lines insurance taxation and regulation consistent with your intent under the Dodd Frank Act. Today NCOIL is releasing to you a report entitled *Implementing the Dodd-Frank Act: State Activity and SLIMPACT, an NCOIL Response.*

Dodd-Frank gave states a very short window of opportunity to comply with NRRA provisions, leaving state legislatures, depending on their session schedules, from as little as 40 days to only six months to pass legislation. Following enactment of Dodd-Frank, NCOIL, CSG, and NCSL to no avail called upon Congress to extend the effective date of NRRA surplus lines provisions by at least one year to give states additional time to join SLIMPACT.

For the last year, states have been trying to figure out how to best protect their current surplus lines tax monies in a time when every state budget dollar counts. Because states have never needed to collect data on home-stated versus multi-state risk, they have no current information to rely upon. As a result, states have reacted in various ways, such as:

- enacting SLIMPACT
- passing legislation to tax 100 percent of premium on home-stated multi-state risks
- authorizing insurance regulators and/or governors to enter into compacts or agreements
- signing an NAIC-backed *Nonadmitted Insurance Multi-State Agreement (NIMA)*
- passing no legislation at all and taking a wait-and-see attitude—or avoiding any tax allocation mechanism

NCOIL, together with CSG and NCSL, has endorsed SLIMPACT as the only policy solution that fully responds to the NRRA, as it would:

- ease the burdensome current system of surplus lines taxation
- provide the uniformity Congress asked for in the NRRA
- and ensure that states receive their fair shares of premium tax dollars on multi-state insurance transactions.

Concerns exist with other approaches that do not fully address Dodd-Frank's intent, such as NIMA, which has and will continue to face constitutional challenges about its improper and unconstitutional delegation of authority to a regulator, who by statute is limited to enforcing laws, not making public policy.

In addition to the legislative groups' endorsement, SLIMPACT is also supported by many of the very folks who asked for the NRRA, including insurance industry and producer organizations, such as:

- American Association of Managing General Agents
- American Bankers Insurance Association
- Council of Insurance Agents and Brokers
- Excess Line Association of New York
- National Association of Professional Surplus Lines Offices
- and Property Casualty Insurers Association of America

SLIMPACT was developed over several years with input from insurance regulators, tax officials, legislators, stamping offices, brokers and trade associations. Modeled after the successful life compact, the SLIMPACT Commission will serve the compacting states and is authorized to create rules agreed-upon by its members. The Commission will establish a national clearinghouse for tax purposes. Responding to the intent of the NRRA, the Commission will create rules for uniform foreign insurer eligibility and a uniform policyholder notice.

Though SLIMPACT becomes fully operational when there are ten compacting or contracting states, Commission representatives from its nine member states have been meeting over the last few months and have developed bylaws and initial rules for rulemaking. SLIMPACT is now honing in on an allocation formula that we are optimistic will—in response to the NRRA—be based upon readily available data with simplicity and uniformity for the surplus lines licensee–not one that will impose new burdens on the industry.

We are also optimistic that states can, as they have for over 135 years, adapt to changes in an increasingly global marketplace and protect their consumers and insurers. Our achievements stand out against the failures of other financial services sectors and show that states can do the job. NCOIL believes that reform can work if it's based on coordination, transparency and disclosure, and accountability—and if it embraces the state system.

Thank you again for the opportunity to address this Subcommittee.

Representative Greg Wren is serving his fourth term as a Republican Member of the Alabama House of Representatives. He is Chairman of the House Local Legislation Committee, Chairman of the Joint Legislative Energy Committee, Vice-Chairman of the House Insurance Committee, Member of the House Ways and Means General Fund Committee, and a Member of the Montgomery County Delegation.

Representative Wren serves as Treasurer of the National Conference of Insurance Legislators (NCOIL), Vice-Chairman of the Commerce, Financial Services, and Communications Committee of the National Conference of State Legislatures (NCSL), Chairman of NCSL's Health Reform Implementation Task Force, member of the American Legislative Exchange Council's (ALEC) Commerce, Insurance and Economic Development Task Force, and a member of The Energy Council.

He holds a B.A. in Public Administration from the University of Alabama and currently owns Wren and Associates with areas of expertise including advocacy efforts in areas such as insurance and financial services, health care, tax and fiscal policy, and military issues. He is also a Chartered Financial Consultant (ChFC) and Charted Life Underwriter (CLU), and has been a Financial Representative with Northwestern Mutual Financial Network more than 30 years.

From 1977-1981, Representative Wren served as a Legislative Analyst for the Legislative Fiscal Office, Staff Assistant to the United State Senate, and served as Governmental Affairs Director for the Alabama Association of REALTORS.

Representative Wren is a member of the Montgomery YMCA Metro Board of Directors, Auburn Montgomery Advisory Board of Directors, Alabama YMCA Youth Legislature Board of Directors, Family Guidance Center Board of Directors, YMCA Tri-Hi-Y Club Advisor, YMCA Camp Chandler Board of Directors, First Baptist Church Disaster Relief and Resource Center Team, Former Chairman of Deacons and Sunday School Teacher for over 25 years, and was recognized as the Montgomery YMCA Man of the Year for 2005.

NCOIL/2011/2007399D

IMPLEMENTING THE DODD-FRANK ACT: STATE ACTIVITY AND SLIMPACT, AN NCOIL RESPONSE

REPORT OF THE NATIONAL CONFERENCE OF INSURANCE LEGISLATORS (NCOIL) TO THE U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE COMMITTEE ON THE JUDICIARY U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

Initially Presented by NCOIL Treasurer Rep. Greg Wren (AL) before the U.S. House Financial Services Subcommittee on Insurance, Housing and Community Opportunity

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JULY 28, 2011

NCOIL
National Conference of Insurance Legislators
...for the states

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PRESIDENT-ELECT: SEN. CARROLL LEAVELL, NM
VICE PRESIDENT: SEN. VI SIMPSON, IN
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Ranking Member, U.S. House Committee on Financial Services

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Chair, U.S. House Committee on the Judiciary

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Ranking Member, U.S. House Committee on the Judiciary

Hon. Tim Johnson
Chair, U.S. Senate Committee on Banking, Housing, and Urban Affairs

Hon. Richard Shelby
Ranking Member, U.S. Senate Committee on Banking, Housing, and Urban Affairs

Dear House and Senate Committee Leadership and Committee Members:

As National Conference of Insurance Legislators (NCOIL) leaders, we write to report on state efforts responding to *Nonadmitted and Reinsurance Reform Act* (NRRA) surplus lines insurance tax provisions in the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Public Law 111-203). In a few short months, states have succeeded in developing an interstate compact to achieve NRRA-desired uniformity.

NCOIL, together with The Council of State Governments (CSG) and National Conference of State Legislatures (NCSL), endorse SLIMPACT as the only mechanism that fully responds to NRRA provisions. The interstate compact—which authorizes development of allocation formulas, uniform payment methods and reporting requirements—also provides for foreign insurer eligibility requirements and a single policyholder notice. As well as being supported by the key organizations of state officials, it enjoys support of major insurance industry and producer stakeholders, including the very folks that urged Congress to incorporate NRRA provisions into the Dodd-Frank Act.

NCOIL legislators—your counterparts in the states—would like to offer a report on state surplus lines activity, as it is legislators who have the power to author state insurance laws. NCOIL recognizes the need for modernization, where appropriate—and has worked hard in the states to respond to NRRA, as the next several pages will detail.

We look forward to working with you further to modernize surplus lines insurance taxation and regulation.

Sincerely,

George Keiser
Rep. George Keiser (ND)
NCOIL President

Carroll H. Leavell
Sen. Carroll Leavell (NM)
NCOIL President-Elect

Vi Simpson
Sen. Vi Simpson (IN)
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RESPONSE TO DODD-FRANK NRRA PROVISIONS
Because of its short window of opportunity for compliance, Dodd-Frank put states in a veritable pressure cooker—with states scrambling to make sense of the surplus lines requirements and to bring forward legislation. States were given only one year to comply. In actuality, most states had only six months to pass legislation and other states less, as certain state legislatures were confined to their normal 40 to 60-day sessions and others meet every other year.

As a *Surplus Lines Insurance Multi-State Compliance Compact* (SLIMPACT) was being developed, NCOIL, CSG, and NCSL have also called upon Congress to extend the effective date of NRRA surplus lines provisions by at least one year until 2012 to give states the time to join the compact.

For the last year, states have been—and the majority still are—trying to figure out how to best protect their current surplus lines tax monies in a time when all state revenue is critical. To do this properly, states must assess their home-stated versus multi-state risks, data that in most states has not been collected. States feel there can be winners and losers in this new game, and no one wants to come out a loser.

As a result, states have reacted in various ways, such as:

- enacting SLIMPACT legislation
- passing legislation to tax 100 percent of the premium on multi-state risks
- in legislation, requiring fiscal analyses prior to joining any compact or agreement
- in legislation, authorizing insurance regulators/governors to enter into multi-state compacts or agreements
- signing National Association of Insurance Commissioners (NAIC)-backed *Nonadmitted Insurance Multi-State Agreement* (NIMA)
- passing no legislation at all—or avoiding any tax allocation mechanism in surplus lines legislation—and taking a wait-and-see attitude

SLIMPACT
NCOIL supports SLIMPACT as the appropriate response to the NRRA. SLIMPACT, as an interstate compact, allows legislatures legally to be part of a single mechanism that will simplify and unify surplus lines tax allocation and collection nationwide, while maintaining authority within the states.

NCOIL lawmakers and others believe SLIMPACT is the only policy solution that would:

- ease the burdensome current system of surplus lines tax allocation and collection
- supply the uniformity that Congress asked for in the NRRA—by providing for important foreign insurer eligibility requirements and the use of a single uniform policyholder notice
- ensure that states receive their fair shares of premium tax dollars on multi-state insurance transactions

NCOIL, along with The Council of State Governments (CSG)—representing all three branches of state government—and the National Conference of State Legislatures (NCSL), have helped develop, and have endorsed, SLIMPACT. SLIMPACT is also supported by The American Association of Managing General Agents (AAMGA), the American Bankers Insurance Association (ABIA), The Council of Insurance Agents and Brokers (CIAB), the Excess Line Association of New York (ELANY), the National Association of Professional Surplus Lines Offices, Ltd, (NAPSLO), and the Property Casualty Insurers Association of America, among others *(See SLIMPACT Overview, Activity, and Background)*.

100 PERCENT TAX ON HOME-STATED MULTI-STATE RISKS
Many states because of the time stricture and the fear of losing tax dollars in 2011 enacted legislation that will allow them to tax 100 percent of home-stated multi-state risks. This, while being a short-term goal, does not address the larger concerns addressed in Dodd-Frank NRRA provisions and could be seen as giving certain larger corporate headquarter states a distinct advantage.

FISCAL ANALYSIS
While the call for a fiscal analysis has been included in certain state legislation—and is certainly warranted in any case, as noted above—states with this language are ignoring, or leap-frogging over, this provision due to time constraints or for other purposes. As of this date, we are unaware of the results of any fiscal analysis, and we understand that any such analysis may be difficult to conclude due to a lack of existing information on multi-state risks.

AUTHORIZING REGULATORS
This approach has raised—and is expected to continue to raise—legal and constitutional challenges. Individual states, industry NRRA proponents, NCOIL, and CSG consider this approach an unconstitutional delegation of authority to regulators, whose statutory duty is to implement laws that have been enacted by the legislature. CSG Legal Counsel Rick Masters, outside of his January 26 legal analysis, has also expressed a more practical concern—noting that case law has generally struck down state participation in compacts when a state adopts a method of ratifying the compact that differs from the terms of the compact, such as legislation providing general agreement authority.

NIMA
A few states have considered or enacted legislation specifically authorizing the state to enter into a *Nonadmitted Insurance Multi-State Agreement* (NIMA) that has been offered by the National Association of Insurance Commissioners (NAIC) as a bare-bones response to the NRRA. As state policymakers who write the insurance laws that state regulators are charged with enforcing, NCOIL lawmakers are concerned with the delegation of legislative authority inherent in NIMA.

Mr. Masters, in a January 26 legal memorandum that is attached with his approval, overviewed constitutional and legal concerns with NIMA language. He argues that state constitutions do not permit executive branch officials to legislate, such as deciding on behalf of a state whether to enter into a multi-state agreement, and then selecting a specific agreement.

NCOIL also echoes concerns raised by numerous insurance industry interested parties that NIMA may not provide necessary efficiencies. By implementing a more burdensome tax reporting and information system than exists today, NIMA could actually introduce inefficiencies into the tax payment process, a clear separation from the goals of Congress and other NRRA advocates.

SLIMPACT OVERVIEW
SLIMPACT is an interstate compact designed to streamline regulatory compliance and tax allocation in connection with multi-state placements of surplus lines insurance. SLIMPACT legislation creates a SLIMPACT Commission as an instrumentality of the compacting states and authorizes it to adopt rules that each compacting state agrees to follow. Each state is represented by one voting member—who is determined via compact state legislation or gubernatorial appointment—on the Commission.

The SLIMPACT Commission is required to adopt rules for tax allocation formulas, clearinghouse reporting, and home state obligations—including premium tax payment and reporting requirements, among others. Equally important to the consistency desired in Dodd-Frank NRRA provisions, SLIMPACT provides for uniform foreign insurer eligibility and a uniform policyholder notice. SLIMPACT empowers the Commission to adopt rules and procedures in connection with financing, administering, and operating the compact, and enforcing compliance with its provisions. SLIMPACT also empowers the Commission to establish Executive and Operations Committees, among others. The Executive Committee, which is made up of Commission members, will manage the Commission, establish and oversee the organizational structure, and appoint and retain an executive director, while the Operations Committee—comprising surplus lines insurance experts—will provide additional technical expertise.

The Commission will establish a single national clearinghouse to receive and disseminate taxes and transaction data. The states will use Commission-approved allocation formulas for the reporting of tax/transaction data to the Clearinghouse, and compacting states could require tax payments, at most quarterly, through state offices, state stamping offices, or through the Commission. The system should serve to protect states' ability to receive premium tax payments on multi-state surplus lines policies.

SLIMPACT ACTIVITY
SLIMPACT was introduced in more than twenty-five percent of the states in the first six months of 2011 and has already been signed into law by governors in nine states:

- Alabama *(June 9)*
- Indiana *(May 9)*
- Kansas *(May 12)*
- Kentucky *(March 16)*
- New Mexico *(April 8)*
- North Dakota *(April 19)*
- Rhode Island *(May 27)*
- Tennessee *(June 10)*
- Vermont *(May 26)*

The New York State Senate, on June 14, approved SLIMPACT legislation that was then referred to the Assembly's Insurance Committee where companion legislation is pending. SLIMPACT is referenced in Georgia, Maryland, and Ohio and is being considered in other states.

SLIMPACT went into effect upon enactment by Kentucky and New Mexico. Its Commission will become fully effective when there are 10 compacting and/or contracting states. A state may contract with SLIMPACT for tax purposes, including the use of the clearinghouse. Alternatively, the Commission may become effective for such purposes when SLIMPACT comprises compacting and contracting states representing greater than forty percent of the nationwide surplus lines premium volume.

The 10-state or 40 percent threshold—which was selected in part to require a critical mass before key decisions could be made—does not prevent the Commission from meeting and developing initial positions. NCOIL, CSG, and NCSL convened three two-hour webinars in late June and early July for such purposes. The series of webinars provided future Commission members, legislators, and interested parties the opportunity to review important start-up procedures, including draft bylaws and an initial draft rule to adopt, amend, and repeal Commission rules. NCOIL also set aside four hours during its July 14-17 Summer Meeting in Newport, Rhode Island, for an inaugural in-person meeting of the Commission to unofficially approve pending proposals, to continue discussion of allocation formulas and methodologies, and to review additional start-up issues and responsibilities.

SLIMPACT BACKGROUND
SLIMPACT was drafted in 2006 and 2007 with input from over 60 insurance professionals representing state regulators, tax officials, legislators, stamping offices, brokers and trade associations. SLIMPACT was envisioned as a national mechanism to streamline surplus lines taxation and regulation.

SLIMPACT was modeled after the successful state speed-to-market modernization effort, the *Interstate Insurance Product Regulation Compact* (IIPRC) that came online for asset-back insurance products, such as life insurance and annuities, in 2006. NCOIL—along with the NAIC and NCSL—was instrumental in the development and adoption of the IIPRC. The IIPRC is celebrating its five-year anniversary in June 2011 and recently announced that a 41st jurisdiction had enacted compact legislation.

NCOIL adopted a resolution in support of SLIMPACT on November 17, 2007, and promptly called upon the NAIC to advocate for the enactment of SLIMPACT. NCOIL, at that time, reiterated its strong support for interstate compacts as an effective means to bring efficiency and uniformity to state insurance regulation. Meanwhile, Congress continued to consider NRRA legislation that would establish home state regulation and taxation of multi-state surplus lines transactions, among other things.

In 2009 and 2010, the NRRA was incorporated into the Dodd-Frank Act. President Barack Obama signed the Dodd-Frank Act on July 21, 2010. NRRA provisions were set to take effect upon the expiration of the 12-month period beginning on the date of enactment—even though many state legislatures had already adjourned their 2010 legislative sessions and would not commence new sessions until January 2011.

The NRRA preempts or otherwise supersedes state surplus lines law in several areas, including subjecting the placement of nonadmitted insurance to the regulatory requirements solely of an insured's home state. The NRRA also includes provisions to streamline the taxation process. It specifically authorizes the States to enter into a compact or to otherwise establish procedures to allocate premium taxes among the States. The Act further states the intent of Congress that "each State adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact…" for tax purposes.

Given the limited time provided under the Dodd-Frank Act to enact national reform, and because SLIMPACT was already developed and was based on a widely successful existing compact, NCOIL again urged the NAIC—which had announced that it would convene conference calls to determine how to respond to the Dodd-Frank Act—to support SLIMPACT.

On August 26, 2010, NCOIL invited leaders of national organizations comprising state officials to an inaugural *State Leader Summit: Working Session on Financial Modernization*, to take place during the November NCOIL Annual Meeting. NCOIL also worked to amend SLIMPACT to address regulator concerns raised on NAIC conference calls that SLIMPACT authority was written broader than was necessary, or called for by the NRRA. NCOIL released what was then called SLIMPACT-Lite, to distinguish it from the original SLIMPACT, in advance of its Annual Meeting. SLIMPACT-Lite maintained tax provisions included in SLIMPACT, and authorized a Commission to establish a uniform policyholder notice, and nationwide foreign insurer eligibility requirements—as permitted under the NRRA. SLIMPACT-Lite deleted a section providing authority to establish optional uniform standards related to licensee banking and bond requirements, among other things.

The State Leader Summit on November 19, 2010, brought together representatives of NCOIL, CSG, the NCSL, the North American Securities Administrators Association (NASAA), and the NAIC. Participants focused on streamlined surplus lines tax collection and allocation, along with annuity suitability and other modernization and uniformity issues. NCOIL, CSG, and NCSL attendees expressed support for SLIMPACT-Lite.

Following the summit, the NCOIL Executive Committee adopted SLIMPACT-Lite on November 21, 2010. A few weeks later, resolutions endorsing SLIMPACT-Lite were adopted by CSG and NCSL, respectively. SLIMPACT-Lite was transmitted to state legislators for their consideration during 2011 legislative sessions. The compact is now known again as SLIMPACT, as it is the only version in circulation. The SLIMPACT-Lite title that was used to distinguish the revised draft as it worked through processes at NCOIL, CSG, and NCSL, is sometimes still used, but the compact text is the same.

NCOIL/2011Docs/2007328g

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MEMORANDUM

TO: NCOIL, NCSL, CSG

FROM: Rick Masters, Special Counsel for Interstate Compacts

RE: NIMA and related legislation

DATE: January 26, 2011

As Special Counsel for Interstate Compacts, The Council of State Governments, I am providing this summary of my recent legal analysis with regard to a proposed legislation in the form of a Non-admitted Insurance Multi-state Agreement (NIMA) which has been endorsed by the National Association of Insurance Commissioners as an alternative proposal to the interstate compact known as the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT) approved and recommended by the National Conference of State Legislators (NCSL) as well as NCOIL and CSG for consideration and enactment by the states. This is being furnished in response to questions about this proposal from various legislators and staff who are reviewing both alternatives in a number of states.

I have reviewed the NIMA proposal and related legislation currently being circulated by NAIC and have previously participated in many teleconferences and other meetings to review numerous versions and proposed amendments to that proposal and have determined that NIMA and related legislation is not an interstate compact and suffers from some serious deficiencies which raise significant doubts as to the legality of the proposal or the ability to enforce its provisions as well as its constitutionality.

My experience in the field of interstate compact law is substantial. As a former General Counsel to CSG, and current Special Counsel to CSG's National Center for Interstate Compacts, I have had the opportunity to provide legal guidance and drafting assistance concerning a wide variety of interstate compacts including several compacts which have been enacted by all fifty (50) states and U.S. territories. I also provide on-going legal advice to several national interstate compact commissions and have also served as litigation counsel in a significant number of state and federal litigation matters pertaining to interstate compacts including both rulemaking and enforcement. A recent example is the favorable decision concerning the validity of the various low-level radioactive waste compacts currently in effect throughout the nation in *Energy Solutions, LLC v. State of Utah et al., 625 F.3d 1261 (2010).* I have also testified before numerous state legislative committees considering various compacts which I have drafted and have spoken on the subject of interstate compacts to a wide variety of groups of state officials including legislators (including NCSL and NCOIL), judges and assistant attorneys general. I have also written widely on the subject including law review articles and I am a co-author of the legal treatise containing the largest published compilation of legal authorities on interstate compacts entitled *"The Evolving Use and Changing Role of Interstate Compacts: A Practitioner's Guide"* (American Bar Association, March 2007).

Based on my review of the proposed agreement and knowledge and professional experience in the field of compact law I have concluded that NIMA fails to provide any substantial or enforceable mechanism for achieving uniformity because it fails to provide a binding agreement which pre-empts other state laws in conflict with it's requirements. Moreover it

Memorandum
January 20, 2011
Page Two (2)

unconstitutionally purports to vest authority in an Executive Branch official (e.g. the Insurance Commissioner) to bind the Legislature of a State which adopts it. NIMA thus usurps Legislative authority because the action which NIMA authorizes to be taken by the Insurance Commissioner contains no limitations or conditions upon which such uniform regulations could be developed or which a state insurance department is otherwise authorized to undertake within its own state. As the U.S. Supreme Court has made clear with regard to the separation of powers, *"[W]here one branch has impaired or sought to assume a power central to another branch, the Court has not hesitated to enforce the doctrine."* See *INS v. Chada,* 462 U.S. 919 (1983), at 963 also *Buckley v. Valeo,* 424 U.S. 1 (1976), at 123.

Under the purposed legislation the Commissioner of Insurance is empowered to "participate in a multi-state compact or reciprocal agreement with other states for the purpose of collecting, allocating, and disbursing to reciprocal states any funds collected . . . applicable to other properties, risks, or exposures located or to be performed outside of this state."

If enacted, this provision vests ultimate control over what form the State's agreement will be in this regard and the Insurance Commissioner is purportedly empowered to unilaterally determine, on behalf of the State, to enter into either a "multi-state compact or reciprocal agreement." The Commissioner of Insurance is thus vested with the authority to legislate on behalf of the State. This is clearly an impermissible delegation to an executive branch official of the power to legislate. See ***Springer v. Government of Philippine Islands, 277 U.S. 189 (1928) at 202.*** *("It may be stated then, as a general rule inherent in the American constitutional system, that, unless otherwise expressly provided or incidental to the powers conferred, the legislature cannot exercise either executive or judicial power;* ***the executive cannot exercise either legislative or judicial power****; the judiciary cannot exercise either executive or legislative power.")* While delegation of rulemaking authority to carry out the more general principles and policies of the legislative body is permissible, as the Court has emphasized, *"The true distinction ... is between the* ***delegation of power to make the law, which necessarily involves a discretion as to what it shall be****, and conferring authority or discretion as to its execution, to be exercised under and in pursuance of the law.* ***The first cannot be done****; to the latter no valid objection can be made."* See ***Loving v. U.S., 517 U.S. 748 (1996) at 759.***

Moreover, because it fails to provide a binding agreement which pre-empts other state laws in conflict with its requirements, the proposal fails to meet the required indicia to constitute a valid interstate compact. See ***Hess v. Port Authority Trans-Hudson Corp., 513 U.S. 30 (1994).*** *("As part of the federal plan prescribed by the Constitution, the States agreed to the power sharing, coordination, and unified actions that typify Compact Clause creations.") Id. at pp. 41-42.* Principal among these characteristics is that Member states may not take unilateral actions, such as the adoption of conflicting legislation or the issuance of executive orders or court rules that violate the terms of a compact. See ***Northeast Bancorp v. Bd. of Governors of Fed. Reserve System*****, 472 U.S. 159, 175 (1985).** The NIMA proposal does not obligate states to adhere to such limitations in addition to the improper delegation of legislative authority to the state's Insurance Commissioner to determine the parameters of the agreement.

It would be my pleasure to speak or correspond with legislators or staff who may have further questions about the compact law and related issues pertaining to the above proposed legislation which has been introduced in several states.

Written Statement of

The Council of Insurance Agents & Brokers

Before

The House Financial Services Committee

Subcommittee on Insurance, Housing and Community Opportunity

Regarding

Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs

July 28, 2011

The Council of Insurance Agents and Brokers represents the nation's leading insurance agencies and brokerage firms. 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 in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

Our testimony today will focus on two critical issues of importance to Council members and their commercial customers – implementation of the surplus lines reform provisions that were included in the Non-Admitted and Reinsurance Reform Act passed last year as part of the Dodd-Frank Wall Street Reform Act (discussed in Section 1 below) and enactment of "NARAB 2" licensure reform (discussed in Section 2 below).

Surplus lines reform was heavily championed by both the insurance agent/broker community and the commercial insureds who are the primary utilizers of surplus lines insurance products. The fundamental thrust of the reform provisions was to require that only a single set of regulations govern a surplus lines transaction – those of the insured's "home state." This was accompanied by Congressional support for the creation of a single, State-based surplus lines regulatory system that would include a harmonious tax payment and allocation mechanism. As of July 21st – the effective date of the NRRA provisions – the States, however, have done everything but create any such harmonious and rationale regulatory system. Indeed, nine States have agreed to enter into a compact (the "Surplus Lines Insurance Multistate Compliance Compact" or "SLIMPACT") that would be designed to create a single comprehensive surplus lines regulatory regime (including a tax allocation mechanism) [1] but another eleven States (and Puerto Rico) have opted to enter into a separate, stand-alone tax sharing agreement (the "Nonadmitted Insurance Multi-State Agreement" or "NIMA"). [2]

Because of the inability of the States to reach a consensus, nine of the largest States – California, Idaho, Illinois, Minnesota, Missouri, New York, Pennsylvania, Virginia and Washington – opted out of any tax allocation system and will retain 100 percent of the surplus lines premium taxes that will be paid by their "home state" insureds. The core NRRA surplus lines directive essentially orders this result and it is a result that will be the most administratively and economically efficient. The remaining twenty-one States (and the District of Columbia) are still evaluating – in one form or another – how best to proceed. We have sent letters to all of those States, asking them to follow California, Illinois, New York, Pennsylvania and the other States who have opted out of the dysfunctional sharing mechanisms and to each create a simple, single-state regulation and taxation mechanism. We ask you to urge them to do the same.

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[1] Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee and Vermont.
[2] Alaska, Connecticut, Florida, Hawaii, Louisiana, Mississippi, Nebraska, Nevada, South Dakota, Utah, Wyoming and Puerto Rico.

Discussion

1. Surplus Lines Insurance Regulatory Reform

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 insureds 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 multistate basis is a morass. This is primarily because, prior to July 21st, if a broker placed a surplus lines product for a commercial client that had insured exposures in 50 states, that transaction was separately regulated by each of those 50 states. Although the nature of that regulation was essentially the same from state to state, the specifics could differ greatly, compounding the problems related to the necessity of complying with as many as 55 different sets of rules for a single transaction.[3]

[3] As a general matter, state surplus lines regulation falls into five categories: (i) taxation; (ii) declinations (requiring brokers to demonstrate that the surplus lines product is not available in the admitted market in

The Nonadmitted and Reinsurance Reform Act (NRRA) – enacted into law in July 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) – changed all of that by limiting the regulatory authority over a surplus lines transaction to the home state of the insured and by setting federal standards for the collection of surplus lines premium taxes, insurer eligibility, and commercial purchaser exemptions. Most of the provisions of the NRRA went into effect last week – on July 21st.

The goal behind the NRRA was not to federalize regulation of surplus lines insurance, nor was it to deregulate. Rather, the intent was to bring about common sense reforms of surplus lines rules at the state level – maintaining state regulation but creating a structure that does away with the conflicting, overlapping rules that made compliance difficult and, in fact, impossible in some instances.

Given the fact that the law was enacted a year ago (after being passed by the House six (?) times in the past four Congresses), and went into effect just last week, one would think the states would be well-prepared for implementation of the NRRA's reforms and a smooth transition to the new rules. Unfortunately, that is far from the case. As with so many opportunities to maintain strong regulations and consumer protections while reforming state insurance regulations to reflect the realities of the modern insurance marketplace, the states have failed to act in a timely, uniform fashion.

To be clear, the provisions of the NRRA that went into effect automatically are in place and providing benefits to both consumers and brokers. Although the states retain the authority to enforce these requirements, the federal law requires that the states follow the federal standards. These include:

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the State); (iii) insurer eligibility (setting rules on the standards a carrier must meet to permit a broker to place a surplus lines policy with that carrier); (iv) regulatory filings; and (v) producer licensing and related issues.

Surplus Lines Insurer Eligibility Requirements: As of July 21, 2011, a surplus lines insurer is subject only to the eligibility requirements of the insured's home state: if the insured's home state does not have insurer eligibility requirements, no such requirements apply; if, however, the home state does have insurer eligibility requirements, they must comply with NRRA. Moreover, eligibility requirements themselves are now uniform across the country (in those states that have them) because the NRRA prohibits states from imposing eligibility requirements on surplus lines insurers except for (i) standards that conform with the NAIC's Non-Admitted Insurance Model Act or (ii) "nationwide uniform requirements, forms and procedures" enacted pursuant to a compact or other agreement among the states.

Exempt Commercial Purchaser Requirements: The NRRA establishes a "commercial purchaser" exemption standard that is applicable in every state. As of July 21, no diligent search in the admitted market is required (and, therefore, a broker can go directly to the surplus lines market) to place a policy for an exempt commercial purchaser if (i) the broker has disclosed to the exempt commercial purchaser that coverage may be available from the admitted market, which may provide greater protection with more regulatory oversight; and (ii) the exempt commercial purchaser has requested in writing that the broker procure/place such coverage with a surplus lines insurer. The term "exempt commercial purchaser" and related terms are defined in NRRA and uniform in every state.

Note that a number of states currently have exemptions for commercial purchasers (called "industrial insureds" in many states). Those exemptions are not preempted by the NRRA. Thus, in those states, if the "industrial insured" exemption is retained, there could be two classes of exemptions: one for entities that meet the NRRA exempt commercial purchaser requirements and one for entities that meet the individual state's industrial insured exemption.

Broker Licensing: As of July 21, a surplus lines broker needs only one surplus lines producer license to place a surplus lines policy – a license (resident or non-resident) in the insured's home state. This is because the NRRA allows only the home state of the insured to impose regulations on a surplus lines transaction. Thus, no state except the home state of the insured can require that a surplus lines broker be licensed in order to sell, solicit, or negotiate surplus lines insurance with respect to the insured.

The NRRA provides a strong incentive to the states to further streamline broker licensing by encouraging the states to use the NAIC's uniform producer licensing applications for surplus lines producers and to license surplus lines brokers electronically through the National Insurance Producer Registry (NIPR). This is because the federal law prohibits a state from collecting fees relating to the licensing of a surplus lines broker or business entity unless the state participates in the NAIC's national insurance producer database for surplus lines producer licensure by July 21, 2012.

That is the good news. In the one area where the states were given leeway in terms of implementation – surplus lines premium taxation – the news is not so good. The states have failed to take advantage of the opportunity offered by NRRA to implement a nationwide, uniform approach that would allow for easier, more certain compliance for brokers, leading to reduced administrative costs, and savings for consumers, as well as regulators.

The NRRA permits only the home state of the insured to require payment of premium taxes in connection with a surplus lines transaction. In a nod to the then-current practices in many states, which imposed surplus lines premium tax in proportion to the location of the risks, the federal law permits states to enter into a compact "or otherwise establish" procedures to allocate taxes among themselves. The intent was to allow the states to simplify the tax filing and payment requirements for brokers and insureds, while still permitting the states to share taxes if they so chose.

Unfortunately, the states have taken advantage of the flexibility of the federal law without making a serious attempt to create the single set of "nationwide uniform requirements, forms, and procedures" envisioned in the NRRA. Led by the state insurance regulators, through the National Association of Insurance Commissioners (NAIC), and the state legislators, through the National Conference of Insurance Legislators (NCOIL), the states have developed competing approaches to surplus lines premium tax.

The state insurance regulators, through the NAIC, created NIMA (the Nonadmitted Insurance Multi-State Agreement), which provides for tax allocation and sharing among signatory states (and prohibits allocating with non-signatory states), and includes a highly detailed premium tax allocation formula that imposes data demands on brokers and insureds that appear to exceed even the most stringent requirements previously imposed by states. Eventually, a central clearinghouse will be created for the payment and allocation of taxes to NIMA states. To date, NIMA has been signed by 11 states and Puerto Rico.[4]

NCOIL has pushed hard for enactment of the Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT). SLIMPACT takes an approach that is both more comprehensive and less defined than NIMA to satisfy the reforms provided for in the NRRA. SLIMPACT is more comprehensive because it addresses not only the tax collection and allocation issues, but also the other regulatory issues addressed in NRRA such as insurer eligibility, insured "home state" determinations, commercial purchaser exemptions, and so forth. At the same time, SLIMPACT is less defined because, although it establishes a clearinghouse for tax payment and allocation, the agreement itself does not establish standards for the clearinghouse or all the regulatory issues it covers. Instead, the compact creates a commission comprised of the compacting states that will, essentially, have authority to set standards and make decisions in connection with these surplus lines regulatory policy issues.

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[4] Alaska, Connecticut, Florida, Hawaii, Louisiana, Mississippi, Nebraska, Nevada, South Dakota, Utah, Wyoming and Puerto Rico.

Like NIMA, however, SLIMPACT has a minority of states participating. In fact, only nine states to date have enacted SLIMPACT and no states have "contracted" with the Compact, so officially, it is unable to take action.[5]

Taken together, SLIMPACT and NIMA involve 20 states and one territory. That leaves 30 states, plus the District of Columbia and remaining territories, who are taking alternative approaches to implement the NRRA's tax standards. In fact, the states have come up with at least four different approaches to taxing surplus lines premium:

(1) Pro-Rata States:[6] These states currently impose tax only on the portion of the risk located in the state. This means that, for transactions on and after July 21, if one of these "Pro-Rata States" is the home state of the insured, the broker will be required to pay tax only on the portion of the risk located in the insured's home state. This group consists of two types of states (1) states that have not changed their premium tax laws to conform to the NRRA by the July 21 deadline (which must, nonetheless, comply with the NRRA's requirement that only the home state of the insured may require surplus line premium tax payments)l and (2) states that have changed their laws to authorize entering into an agreement or compact but have not yet done so, and that, in the meantime, have left their current pro rata approach to taxation in place.

(2) 100% Retention States:[7] As of July 21, a number of states tax 100% of the premium on surplus lines policies and do not allocate the taxes to other states where covered risks are located. This means that, for transactions on and after July 21, if one of these "100% Retention States" is the home state of the insured, the broker is required to pay tax to the home state of the insured on the entire amount of the premium, most likely at the home state's tax rate.

[5] Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee and Vermont.
[6] Colorado, District of Columbia, Iowa, Michigan, South Carolina, and Wisconsin.
[7] California, Idaho, Illinois, Minnesota, Missouri, New York, Pennsylvania, Virginia and Washington.

There are also a number of states that will tax 100% of the premium unless/until the state enters into a compact or agreement to allocate the tax.[8] (For example, Arkansas requires payment of 100% of the premium tax to the state at the state's surplus lines premium tax rate of 4% unless the insurance commissioner enters into NIMA. At that time, taxes will be paid in accordance with NIMA.)

(3) NIMA States:[9] As discussed above, 11 states have signed on to NIMA. It is not yet known when NIMA's clearinghouse will be operational. In the meantime, if a "NIMA State" is the home state of the insured, the broker presumably will be required to follow NIMA's allocation and reporting requirements. Having said that, guidance from the states has been limited. Because the NIMA clearinghouse is not yet operational, further guidance from the NIMA states will be needed so that brokers know the proper procedures to follow for tax payment, reporting and allocation until the clearinghouse is functional.

In states that are authorized to enter into NIMA but have not done so, brokers should look to the laws of each state to determine premium tax payment requirements until such time as the state has entered into NIMA.

(4) SLIMPACT States:[10] As discussed above, only nine states have enacted SLIMPACT legislation and no states have "contracted" with SLIMPACT to use the Compact to allocate taxes. SLIMPACT's clearinghouse will not be operational until at least July 2012. In the meantime, brokers and insureds have to look to the home state of the insured for guidance as to how to pay applicable taxes, including the rates and allocation formulas, if any. The rules and allocation formula for SLIMPACT are currently being drafted, but cannot come into effect until the Compact itself has at least 10 states participating.

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[8] Arizona, Arkansas, Delaware, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, North Carolina, Ohio, Oklahoma, Texas, and West Virginia.
[9] Alaska, Connecticut, Florida, Hawaii, Louisiana, Mississippi, Nebraska, Nevada, South Dakota, Utah, and Wyoming (and Puerto Rico).
[10] Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee and Vermont.

Because the SLIMPACT Commission will not have established compliance rules and the SLIMPACT clearinghouse will not be operational by July 21, further guidance from the SLIMPACT states will be needed so that brokers know the proper procedures to follow for tax payment, reporting and allocation until the clearinghouse is functional.

A chart is attached illustrating the tax allocation formula currently being employed by each State as of the July 21st implementation date by regime type as outlined above.

In addition to the general confusion raised by the multiple state tax approaches, some of the specific decisions by the states (or the lack of decisions in some cases) have caused compliance problems for brokers and insureds during the transition period leading to the July 21 effective date, and have the potential to cause greater problems going forward.

For example, in enacting their new surplus lines premium tax laws, many states, whether intentionally or not, ignored the NRRA's July 21 compliance date. These state laws became effective weeks or months before July 21. Thus, instead of all the states enacting the new "home state" tax rules on a single date, the laws came into effect piecemeal. This led to needless complications for brokers and insureds seeking to comply with the laws. Florida's law, for instance, went into effect on July 1 (as did a number of other states). As of that date, all surplus lines transactions involving insureds whose home state is Florida were required to pay 100% of the premium tax to Florida. Because the NRRA was not yet in effect, however, other states still imposed tax on the portion of non-residents' risks located in their states. As a result, brokers and insureds were subjected to double taxation on those policies.

In addition to the double-taxation issue, many state laws are simply not clear with respect to the rates to be applied. Is the home state rate applied to the entire premium?

Or are multiple rates to be applied depending upon the location of the risk? This is particularly problematic during the transition periods: for NIMA and SLIMPACT states, those are the periods between the time their laws became effective and the time that NIMA and SLIMPACT actually become operational; for other states, that may be the period between the effective date of the applicable state's law and July 21, or it could be the period between July 21 and the date the state decides to enter (or not) NIMA or SLIMPACT.

Other questions remain unanswered, further illustrating the states' lack of preparation despite ample time:

Will 100% retention states require filing of allocation reports?

Absent a functioning clearinghouse, how will brokers calculate and pay premium taxes in the NIMA states?

In conclusion, despite the states' remarkable inability to take advantage of a prime opportunity to show they can work together to modernize and streamline regulation to both protect consumers and reflect current market realities, surplus lines regulation is today a more streamlined, efficient system than the pre-NRRA world, where each state taxed the risk located within its borders. Moreover, because of the federal law's home state mandate, there is less risk of state laws conflicting and thereby preventing brokers and insureds from full compliance.

2. NARAB 2 and Producer Licensure Reform

States have been able to make some concrete progress in their regulatory reform efforts 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 therefore are very supportive of the incremental reform bill introduced by Representatives Randy Neugebauer and David Scott that is commonly called "NARAB II," which would create an interstate producer licensing clearinghouse and which has been approved several times by the full House Financial Services Committee.

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. Even more problematic are the disparities among the states regarding business entity licensing. While the NAIC's Producer Licensing Model Act did bring some uniformity to the producer licensing process, it still left many of the decisions regarding the licensing process to the individual states. Most of the states have enacted the entire PLMA, but 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 business entity licenses for itself and its subsidiaries/affiliates. My firm and our individual producers hold a total of thousands of licenses. And this is not a "once and done" deal – state licenses, by and large, must be renewed annually throughout the year, based upon the individual requirements in each state, and there are continuing regulatory requirements and post-licensure oversight that must be attended to, as well. As you can imagine, this requires significant monetary and human resources from each and every producer. This is especially frustrating because, let's face it, the incremental consumer protection value of the tenth or hundredth or thousandth or 50,000th license is questionable, at best.

In addition to the lack of full reciprocity in licensing procedures for non-residents, the standards by which the states measure compliance with licensing requirements differ from state to state, as well. These include substantive requirements – pre-licensing education, continuing education and criminal background checks, for example – as well as administrative procedures such as agent appointment procedures and license tenure and renewal dates.

It also applies to interpretation and application of statutory language. For example, as I have mentioned, most of the states have enacted new producer licensing laws based in whole or part on the NAIC's Producer License Model Act, which was adopted by that organization in 2000. Yet twelve 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 is 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 noted above, 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 NAIC maintains a regulatory actions database that state regulators should be able to access regarding questions about a producer's prior regulatory or legal issues. They should look to available resources of this nature first before continuing to bog down the licensing process with additional procedures.

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.

Conclusion

As you can see from my testimony, the states continue to prove themselves unable to move towards regulatory uniformity and simplicity even when given a mandate by Congress. States continue to labor under an insurance regulatory system that was designed for the 1940s, when interstate commerce was far less prevalent. They should be adopting a regulatory system that not only takes advantage of technological advances to streamline the system but also recognizes the prevalence not only of interstate commerce but of international commerce. To do otherwise will continue to put the US at a competitive disadvantage as regulatory burdens bog down producers who should be assisting clients with complex risk management and insurance placements and not faxing forms to regulators or having multiple sets of fingerprints taken for background checks.

I appreciate the opportunity to share The Council's thoughts on insurance regulatory reform with you today, and would be happy to answer any questions you may have.

# # #

STEPTOE & JOHNSON LLP

Jurisdictions by Surplus Lines Tax Regime Type		
Last Updated 7/26/11		
100% Jurisdictions (24)		
No legal Authority to Allocate via Multi-State Agreement	**Legal Authority to Allocate via Multi-State Agreement, but Authority Not Yet Exercised**	**States Authorizing Studies of Multi-State Agreements (* denotes agreement authorized after study)**
CA	AR	AZ*
ID	MT	**DE*
IL	NH	GA*
MN	**NJ	ME*
MO	OK	MD*
NY	TX	MA* (public notice and comment required)
PA	WV	NC
VA		OH*
WA		
Total - 9	**Total - 7**	**Total - 8**
Pro Rata Jurisdictions (7)		
No legal Authority to Allocate via Multi-State Agreement	**Legal Authority to Allocate via Multi-State Agreement, but Authority Not Yet Exercised**	
CO	**OR	
DC		
IA		
MI		
SC		
WI		
Total - 6	**Total - 1**	

STEPTOE & JOHNSON LLP

Jurisdictions with Tax Allocation Agreements (21)		
SLIMPACT	**NIMA**	
AL	AK	
IN	CT	
KS	FL	
KY	HI	
NM	LA	
ND	MS	
RI	NE	
TN	NV	
VT	PR	
	SD	
	UT	
	WY	
Total - 9	**Total - 12**	
** Denotes Legislation Not Yet Enacted - Awaiting Governor's Signature		

JUDY BIGGERT
13TH DISTRICT, ILLINOIS

COMMITTEES:
FINANCIAL SERVICES
EDUCATION AND THE WORKFORCE
SCIENCE, SPACE, AND TECHNOLOGY

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May 20, 2011

The Honorable Jo Ann Emerson
Chairman
Subcommittee on Financial Services and
General Government
House Appropriations Committee
B-300 Rayburn House Office Building
Washington, DC 20515

The Honorable José Serrano
Ranking Member
Subcommittee on Financial Services and
General Government
House Appropriations Committee
1016 Longworth House Office Building
Washington, DC 20515

Dear Chairman Emerson and Ranking Member Serrano:

As you begin work on the Fiscal Year 2012 Financial Services and General Government Appropriations bill, I write to request your consideration of report language that will reaffirm Congressional intent regarding the implementation of the so-called "Volcker Rule," particularly as it relates to the insurance industry.

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) (P.L. 111-203), commonly referred to as the "Volcker Rule," is intended to eliminate excessive risk-taking activities by banks and their affiliates while preserving safe and sound investment activities, Section 619 requires the Financial Stability Oversight Council (FSOC), a 15-member inter-agency group established under Title I of the Dodd-Frank Act, to conduct a study of the Volcker Rule, and federal regulators to subsequently implement it through a joint rulemaking. In addition, the Subsections (b)(1)(F) and (d)(1)(F) of Section 619 clearly state an exception to the Volcker Rule for the investment activity of regulated insurance companies for their general accounts, including investing in both sponsored and third-party investment funds, subject to the various state insurance company investment laws.

For three reasons, it is necessary for Congress to reaffirm the intent of Section 619 of the Dodd-Frank Act as it relates to this insurance exception to the "Volcker Rule." First, Title I of the Dodd-Frank Act establishes FSOC and includes in its membership three insurance experts, including a voting member with insurance expertise. However, there currently is no voting member with insurance expertise on FSOC because the President has not nominated anyone to fill this position. Second, Title I of the Dodd-Frank Act also requires FSOC to include two non-voting members with insurance expertise, the Director of the Federal Insurance Office (FIO) and a representative of the State insurance regulators. At this time, the FIO Director has been appointed by the Treasury Secretary but has not assumed his responsibilities, and the representative of the State insurance regulators serving on FSOC has testified before the House Financial Services Committee that he has been prohibited from freely consulting with other State regulators on FSOC related matters. Third, without the required insurance representation, FSOC released the statutorily required study on the Volcker Rule, and is coordinating the efforts of federal banking regulators, the U.S. Securities and Exchange Commission, and the U.S. Commodity Futures Trading Commission to draft regulations to implement the Volcker Rule.

Therefore, I respectfully request that you consider including in the Committee's report to accompany the Fiscal Year 2012 Financial Services and General Government Appropriations bill the following language to reaffirm the Congressional intent of the Dodd-Frank Act insurance exemption as it relates to the Volcker Rule:

> *In P.L. 111-203, subsequent to a study issued by the Financial Stability Oversight Council (FSOC), Congress directed FSOC to coordinate the efforts of the appropriate federal banking regulators, the U.S. Securities and Exchange Commission, and the U.S. Commodity Futures Trading Commission to promulgate regulations, known as the "Volcker Rule," that "appropriately accommodate the business of insurance." The Committee believes that the traditional investment activities of state-regulated insurance companies for their general accounts, including investing in both sponsored and third-party funds, are preserved by the law without constraint.*
>
> *The Committee is concerned the rule-making process is moving forward without a Senate-confirmed voting Member of FSOC who can represent the views of the insurance industry.*
>
> *The Committee looks forward to reviewing the proposed regulations to ensure that Congressional intent is fulfilled.*

Thank you for your attention to my request.

Sincerely,

Judy Biggert

Judy Biggert
Chairman
Subcommittee on Insurance, Housing, and
Community Opportunity
Committee on Financial Services

SPENCER BACHUS, AL, CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

BARNEY FRANK, MA, RANKING MEMBER

February 10, 2011

The Honorable Timothy Geithner
1500 Pennsylvania Ave, NW
Washington, DC 20220

Dear Secretary Geithner:

We are writing to express our concern that the Financial Stability Oversight Council (FSOC) is proceeding with discussions on major issues affecting the insurance sector without the benefit of a full complement of insurance expertise, which is contrary to the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203).

The Dodd-Frank Act provides for three seats on the FSOC for individuals with specific expertise in the insurance area. The legislative intent in providing for these expert perspectives was to ensure that the Council has a full and thorough understanding of the insurance sector and its current regulatory regime prior to moving forward with any significant actions that could impact the business of insurance. We are concerned that two of the three positions remain vacant, including the Director of the Federal Insurance Office and the Council seat reserved for a presidentially-appointed independent insurance expert, which represents the only insurance position on the Council with voting privileges.

In addition, while one of the two non-voting insurance seats has been filled to provide the important perspective of state insurance regulators, we encourage you to ensure that the designated state insurance commissioner is allowed to utilize state regulatory resources to the extent he deems necessary to carry out his responsibilities, with appropriate confidentiality safeguards, just as the other members of the Council have ample staff support available to them.

The U.S. insurance sector represents a critically important component of the U.S. economy, with substantial domestic and international operations. The Dodd-Frank Act was enacted over six months ago and the FSOC is currently at work developing rules, procedures and policies that will have long-term effects on much of the insurance sector. Given the unique nature of the business of insurance, we believe it is imperative that the insurance-related seats on the FSOC be filled without further delay.

Thank you for your consideration of our concerns, and we look forward to hearing from you on the status of these appointments as soon as possible.

Sincerely,

SPENCER BACHUS
Chairman

BARNEY FRANK
Ranking Member

JUDY BIGGERT
Chairman
Subcommittee on Insurance, Housing, and Community Opportunity

LUIS GUTIERREZ
Ranking Member
Subcommittee on Insurance, Housing, and Community Opportunity

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

March 9, 2011

The Honorable Judy Biggert
U.S. House of Representatives
Washington, DC 20515

Dear Representative Biggert,

Thank you for your letter of February 10, 2011, regarding the two open positions on the Financial Stability Oversight Council (the "FSOC") for members with insurance expertise. We share your view on the importance of filling those seats.

As you know, Congress requires the Federal Insurance Office to be headed by a Director who will be a member of the Senior Executive Service. The Department of the Treasury is following federal hiring rules to fill the position and we will make an appointment soon. Furthermore, the President appoints the independent member of the FSOC with the advice and consent of the Senate. The White House is reviewing candidates for that nomination.

The FSOC now benefits from the service of Mr. John Huff, who was selected as a member by the state insurance commissioners. Mr. Huff offers a breadth of knowledge and the important perspective of the primary functional insurance regulators.

I appreciate your attention to this matter. I look forward to continuing to work with you on this and other important issues.

Sincerely,

Timothy F. Geithner

Identical letter sent to:
The Honorable Barney Frank
The Honorable Spencer Bachus
The Honorable Luis Gutierrez

STATEMENT
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING
AND COMMUNITY OPPORTUNITY

UNITED STATES HOUSE OF REPRESENTATIVES

July 28, 2011

Introduction

The Independent Insurance Agents & Brokers of America's (IIABA) support for state insurance regulation is well-known to observers of the insurance industry and to the members of the subcommittee, and we continue to confidently believe that states are the most appropriate and effective regulators of this vital financial sector. This longstanding position was vividly reinforced during the financial crisis of recent years. During challenging and tumultuous times, state insurance regulators ensured that insurers remained solvent, that claims were paid, and that consumers were protected. State regulators handle countless inquires and questions from consumers and understand the concerns and often unique conditions facing the citizens in their states. State regulation has a particularly long and stable track record of accomplishment in the vital areas of solvency regulation and consumer protection. Although targeted federal legislation is sorely needed in a number of key areas to modernize and improve the state regulatory system, especially in the area of agent licensing, the underlying foundation on which the state regulatory system is based is strong and stable.

Dodd-Frank Act Implementation

It was only one year and one week ago today that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was signed into law. Regardless of one's views of Dodd-Frank, it was appropriate that the treatment of the insurance sector ultimately proved to be relatively noncontroversial. The decision not to dramatically restructure the state system was a conscious and welcome one, and it reflected the consensus among policymakers that the turmoil in the markets was not exacerbated by and did not significantly extend into the insurance world. The members of this subcommittee and your colleagues in the House and Senate recognized the steady performance of state insurance regulation during the financial crisis and concluded that sweeping action in the insurance arena was unnecessary and unwarranted.

Although the insurance sector was not the focal point of the Dodd-Frank reforms, there are several important and notable insurance-related provisions contained in the law. Three provisions are of particular interest to IIABA and are discussed in greater detail below.

Surplus Lines Regulation

For many insurance agents and brokers, the most notable insurance features of Dodd-Frank are reforms made to the surplus lines marketplace. These provisions – which are contained in the Nonadmitted and Reinsurance Reform Act (NRRA) and only took effect one week ago today – offer the possibility of meaningful reform and marketplace efficiency, but it is too early to determine with certainty whether their promise will be realized.

The NRRA surplus lines reforms attempt to eliminate much of the unnecessary duplication and redundancy that historically existed in this arena by embracing a single state regulatory approach. The law requires jurisdictions to respect the requirements and conclusions of the insured's home state and specifically provides that "the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home state." The net effect of these provisions is that only the surplus lines licensing, diligent search, disclosure, and all similar placement requirements of the home state are to apply in any particular transaction. The law also includes a clear preemption provision stating that "any law, regulation, provision, or other action of any state that applies or purports to apply to nonadmitted insurance sold to, solicited by, or negotiated with an insured whose home state is another state shall be preempted with respect to such application."

The move to a single state-home state regulatory system is a significant modernization of existing law, but NRRA also promotes interstate regulatory consistency by developing national standards in the areas of insurer eligibility and diligent search requirements. The inclusion of these additional provisions should be very beneficial to agents and brokers active in the nonadmitted insurance marketplace.

IIABA is optimistic about the establishment of a single state regulatory system and of national standards in these key areas, but the manner in which states implement and respond to this new paradigm will be critical. It is essential that state officials adhere to the letter and spirit of the law. States must resist the possible temptation to ignore the intent of these reforms and attempt to circumvent the law by imposing state requirements that are inconsistent with the NRRA.

Many, but not all, states revised their surplus lines requirements in the 2011 legislative session in order to conform their state laws to the new federal requirements. It will be critical that all states achieve this same consistency. Although it is very clear that the NRRA will preempt state laws that are inconsistent with its standards, IIABA firmly believes that it is important to eliminate the possibility of confusion and conflict. While some states have pledged to no longer enforce state statutory and regulatory provisions that conflict with the NRRA, the best possible course is for these jurisdictions to avoid any possible ambiguity and simply repeal these requirements altogether.

The National Association of Insurance Commissioners (NAIC) has helped educate state insurance officials and the insurance industry about the scope and effect of the NRRA's non-tax provisions by issuing a sample bulletin. This sample bulletin provides helpful information in a "frequently asked questions" format and can be modeled for use by state insurance departments. IIABA urges more states to issue such guidance in their particular jurisdictions.

While IIABA remains hopeful that the NRRA's above-described non-tax provisions will be implemented as intended by Congress, we are more concerned by the implementation of the NRRA's tax provisions. The collection and distribution of surplus lines premium taxes has been a confusing and complex challenge for surplus lines brokers for many years, and the NRRA reforms address this problem by again embracing single state regulation and permitting only the home state of the insured to require the payment of premium taxes in connection with a surplus lines transaction or direct nonadmitted insurance placement. The statute leaves no ambiguity about the intended goal and provides that "[n]o state other than the home state of an insured may require any premium tax payment for nonadmitted insurance." We are increasingly troubled, however, that this simple provision may lead to an unintended result that actually exacerbates existing burdens and challenges.

The NRRA acknowledges that states may enter into interstate compacts or agreements in order to allocate premium taxes for multistate surplus lines risks, but participation in such a system is not required by the law. Two interstate alternatives – the Nonadmitted Insurance Multistate Agreement (NIMA) and the Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT) – are under development, but neither is functional or operational at this time. At least twelve states have so far expressed a desire to participate in the NIMA system (although no tax payment clearinghouse has been established), and nine states have enacted the necessary statutes to join SLIMPACT (although that interstate compact will not be fully operational before January 2013).

IIABA is closely monitoring and is concerned by the manner in which the potential interstate agreements address the allocation, collection, and distribution of premium taxes on insurance policies covering exposures in multiple states. We believe strongly that any allocation methodology must be efficient, sensible, and not result in increased burdens and compliance obligations for insurance brokers or purchasers of coverage. The NIMA agreement – which was developed by the NAIC's Surplus Lines Implementation Task Force and ultimately approved by the NAIC as a whole – currently contemplates an allocation methodology that is of considerable concern to the private sector, and it is one that fails to satisfy the principles that IIABA and others expect from such a system. NIMA's proposed allocation system would be more complex and cumbersome than that in place today and would require the collection of information that is not even utilized in the underwriting process.

While we have serious reservations about the NIMA proposal approved by the NAIC in late 2010, it is still possible for the participating NIMA jurisdictions to revise the allocation methodology before the system goes live. A number of preferable alternatives have been proposed, but perhaps the most viable of these options is a tax allocation proposal that has been crafted by the Kentucky Department of Insurance. Kentucky Insurance Commissioner Sharon Clark, who also chairs the NAIC's Market Regulation and Consumer Affairs Committee, has proposed a methodology that has considerable merit and addresses the biggest problems associated with the current NIMA allocation system. IIABA hopes the participating NIMA states will adopt this thoughtful proposal, and we urge them to do so at the earliest possible time.

The NRRA was intended to streamline and simplify the surplus lines regulatory system. It would be a very peculiar outcome and an unintended consequence of Congress's action if the NRRA's enactment ultimately prompted state officials to develop an even more complex and cumbersome regulatory structure for the agents, brokers, and purchasers of surplus lines insurance. IIABA intends to work with all parties, however, and remains hopeful that the promise of the NRRA can ultimately be realized.

Federal Insurance Office

In addition to playing a role in the implementation of the NRRA surplus lines provisions, IIABA is greatly interested in the manner in which the recently established Federal Insurance Office (FIO) will function. Congress, thanks in large part to the work of this subcommittee, clearly spelled out the purpose, role, and authority of the new office in Dodd-Frank, and it is imperative that the informational office operate as intended. The FIO serves a limited, albeit important, purpose and is authorized – among other activities – to monitor the industry, serve on the Federal Stability Oversight Council, and collect certain data from the industry. At the same time, however, it is important to remember the office's activities are restricted in many crucial ways and that the entity lacks any formal regulatory authority over the business of insurance.

IIABA welcomes and looks forward to working with the newly installed director of the office – former Illinois Insurance Director Michael McRaith – and expects that his lengthy experience as a regulator and advocate of state regulation will serve him well in his current capacity. We especially look forward to providing our input to the FIO as it begins its work on the study examining how to modernize and improve insurance regulation.

Financial Stability Oversight Council

For over 150 years, the United States has relied on an insurance system regulated by the states. This state-based system has proven its strength with a strong track record of protecting policyholders and claimants while simultaneously upholding the integrity of the insurance markets. As the Financial Stability Oversight Council (FSOC) continues to determine the entities it will deem systemically risky, warranting additional federal scrutiny, it should recognize that the insurance industry as a whole does not present a systemic risk.

There are several reasons why the insurance industry is not systemically risky. First, the system protects against insolvency and the insurance market is extremely competitive. If an insurance company becomes insolvent, the state insurance regulator has a process to wind down the failing institution, and a strong state guaranty fund protects the individual policyholders from losses. Second, the insurance marketplace is extremely competitive, so the loss of a single failed company typically does not produce gaps in the market.

Third, the insurance industry (particularly property casualty insurance) should not be considered systemically risky, as insurers carry lower leverage ratios and hold greater amounts of capital in relation to their liabilities than other financial institutions. As a result, this reduces their exposure to market instability. Fourth, the inherent nature of insurance reduces systemic risk because insurance companies are financed by premiums paid in advance and pay only when an insured event occurs. Unlike other potentially systemically-risky industries, the insurance industry is shielded from a potential run-on-the-bank scenario. Finally, as an additional safeguard, state regulators have broad authority to take insurers into receivership, effectively "walling off" their assets from the holding company and providing priority to policyholders. Any decision by FSOC to include insurance companies in its oversight should recognize these inherent differences between the insurance industry and other financial services sectors.

Producer Licensing Reform and the Need for NARAB II

While the enactment of the NRRA is an important step forward in the pursuit of meaningful regulatory modernization and will hopefully achieve its intended result, it is imperative that the state regulatory framework continue to advance and improve in other ways. While we support the preservation of the state system, we are just as strongly committed to the pursuit and implementation of regulatory and legislative reforms that address the weaknesses, inefficiencies, and unnecessary duplication that continue to hinder its effectiveness. State regulation offers considerable benefits, but the difficult truth is that sufficient progress on producer licensing reform and similar marketplace access issues have not been achieved. The need for effective licensing reform is greater than ever.

State law requires insurance agents and brokers to be licensed in every jurisdiction in which they conduct business, which forces most producers today to comply with inconsistent standards and duplicative licensing processes. These requirements are costly, burdensome and time consuming, and they hinder the ability of insurance agents and brokers to effectively address the needs of consumers. In fact, the current licensing system is so complex and confusing for our members that many are forced to retain expensive consultants or vendors or hire staff people dedicated to achieving compliance with the requirements of the states in which they operate.

Some observers mistakenly believe that most insurance agents operate only within the borders of the state in which they are physically located and that the problems associated with the current licensing system only affect the nation's largest insurance providers. The marketplace, however, has changed considerably in recent decades, and the average independent insurance agency today operates in more than eight jurisdictions. There are certainly agencies that have elected to remain small and perhaps only service the needs of clients in one or two states, but that is no longer the norm. For smaller businesses, which lack the staff and resources of larger competitors, the exorbitant cost and unnecessary complexity of ongoing licensing compliance is especially burdensome.

Congress recognized the need to reform the industry's multistate licensing system in the 1990s and incorporated the original NARAB subtitle into the Gramm-Leach-Bliley Act (GLBA). GLBA did not provide for the immediate establishment of the National Association of Registered Agents and Brokers (NARAB) and instead included a series of provisions that encouraged the states to reinvent and simplify the licensing process. In order to forestall the creation of NARAB, at least a majority of states (interpreted to be 29 jurisdictions) were required to license nonresidents on a reciprocal basis. To be deemed "NARAB compliant," GLBA mandated that states issue a nonresident license to any applicant who meets three simple criteria: (1) is licensed in good standing in his/her home state, (2) submits the appropriate application, and (3) pays the required fee. The act is precise and states that a nonresident license must be issued "without satisfying any additional requirements." In short, GLBA required compliant states to accept the licensing process of a producer's home state as adequate and complete, and no additional paperwork requests or other requirements are permitted (no matter how trivial or important they may seem).

IIABA believes the most efficient, effective, and sensible way to address the licensing and marketplace access problems discussed above is through the NARAB II legislation that has twice passed the House of Representatives. This legislation has once again been introduced in this Congress by Reps. Neugebauer (R-TX) and David Scott (D-GA). The current bill, H.R. 1112, has nearly 60 bipartisan cosponsors. The measure has enjoyed broad industry and strong bipartisan Congressional support in the past as well.

The NARAB II proposal would immediately establish the National Association of Registered Agents and Brokers and provide agents and brokers with a long-awaited vehicle for obtaining and maintaining licenses on a multistate basis. It would eliminate barriers faced by agents who operate in multiple states, establish licensing reciprocity, and create a one-stop facility for those who require nonresident licenses. The bipartisan bill benefits policyholders by increasing marketplace competition and consumer choice and by enabling insurance producers to more quickly and responsively serve the needs of consumers.

H.R. 1112 ensures that any agent or broker who elects to become a member of NARAB will enjoy the benefits of true licensing reciprocity. In order to join NARAB, however, an insurance producer must be licensed in good standing in his/her home state, undergo a criminal background check (long a priority of state insurance regulators), and satisfy the independent membership criteria established by NARAB. These criteria would include standards for personal qualifications, training, and experience, and – in order to discourage forum shopping and prevent a race to the bottom – the bill instructs the board to "consider the highest levels of insurance producer qualifications established under the licensing laws of the states."

NARAB's simple and limited mission would be to serve as a portal or central clearinghouse for license issuance and renewal. The bill discretely utilizes targeted congressional action to produce marketplace efficiencies and is deferential to states' rights at the same time. H.R. 1112 merely addresses marketplace entry and leaves regulatory authority in the hands of state officials. The proposal does nothing to limit or restrict the ability of state regulators to enforce state marketplace and consumer protection laws. State officials will continue to be responsible for regulating the conduct of producers and will, for example, investigate complaints and take enforcement and disciplinary action against any agent or broker who violates the law. In short, the NARAB II proposal would strengthen state insurance regulation, reduce unnecessary redundancies and regulatory costs, and enable the industry to more effectively serve the needs of insurance buyers – and it would achieve these results without displacing or adversely affecting state regulatory oversight.

Conclusion

The Independent Insurance Agents and Brokers of America thanks the subcommittee for its efforts – past and present – to implement tangible and effective marketplace improvements. We appreciate your focus on ensuring that the surplus lines reforms and Federal Insurance Office provisions of the Dodd-Frank Act are implemented as intended, and we particularly look forward to working with you on the much-needed NARAB II proposal in the near future.

NAIFA®

NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS

Statement in connection with a hearing of

The House of Representatives

Financial Services Subcommittee on Insurance, Housing and Community Opportunity

"Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs."

July 28, 2011

The National Association of Insurance and Financial Advisors (NAIFA) appreciates the opportunity to share with the members of the House of Representatives Financial Services Subcommittee our views regarding insurance oversight and the importance of a modern, efficient and effective insurance regulatory system. We welcome the Subcommittee's interest in this issue, which is so important to insurance agents and advisors, and to the insurance consumers whom we serve.

NAIFA comprises more than 600 state and local associations representing the interests of our members nationwide. NAIFA members represent and serve Main Street. They are community-based small business owners, many working as sole practitioners, who provide affordable insurance and financial services to the middle-market. Our members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. Founded in 1890 as The National Association of Life Underwriters, the vision of NAIFA is to protect and promote the critical role of insurance in a sound financial plan and the essential role provided by professional agents and advisors. NAIFA's website can be accessed at www.naifa.org.

Modernizing Insurance Oversight is Essential for a Strong and Healthy Insurance Marketplace

NAIFA members are long-time supporters of state regulation and remain steadfastly committed to this tradition. Having said that, we recognize that there are deficiencies in the state insurance regulatory system and that reform is needed to protect consumers and to ensure a strong and healthy insurance marketplace. We believe, as others do, that fixing the problems with the insurance regulatory system ultimately will enable the insurance industry to provide better and greater choices for consumers, without sacrificing consumer protection.

In addition to the existing regulatory challenges, the changing dynamics of the financial services industry in the 21st century compel NAIFA to be open to all promising options to improve the regulation of the industry. Insurance producers have been working with state insurance regulators for years to encourage sensible reforms to make the quilt of state insurance laws and regulations more uniform, thus enabling producers to better compete in an increasingly crowded financial services marketplace. Improvements in regulation benefit consumers, as well, who share the heavy burden of paying for the costs of complying with the current system.

Insurance regulation has been slow to adapt to changes in the industry and the markets it serves, resulting in the regulatory problems that exist today. Unnecessary distinctions among the states and inconsistencies within the states on issues such as licensing, product approval, and consumer protection, thwart competition, reduce predictability and add unnecessary expenses to the cost of doing business. Similarly, these outdated rules and practices do not serve the goals of regulation in today's converging financial services marketplace.

We recognize the challenges facing state regulators in their efforts to achieve reform. It has proved to be very difficult for state regulators and their legislatures to unilaterally correct the identified deficiencies in state insurance regulation. Both practical and political realities dictate that, if identical bills are proposed in 50 state legislatures, 50 different bills will emerge from those 50 separate legislative processes. There are numerous reasons for this lack of success – lack of will, disagreements over substantive details, structural impediments, and the fact that it is simply very difficult to get 50 different jurisdictions to act in a coordinated fashion, and act quickly in a constantly changing global marketplace.

State insurance regulators have made great efforts in the past several years to reform and modernize the system, working through the NAIC to devise regulatory reforms on the national level and institute them state-by-state. Unfortunately, their efforts have met with limited success. The financial accreditation program and the interstate compact for life insurance products are examples of state regulation and cooperation at its best. But the wheels of state regulation move slowly, and, beyond the accreditation program, it has proved nearly impossible to achieve consensus on, and uniform implementation of, model laws and rules. Even the life insurance compact, which is an undisputed success for the states, has taken years to reach its current contingent of 40 states.

Producer Licensing Reform Illustrates the Difficulty the States Have Achieving Nationwide Results

An area of insurance oversight that is critically important to NAIFA members is producer licensing and regulation. NAIFA has worked for years to get the NAIC and state insurance regulators to fix the cumbersome, duplicative state-based system of producer licensing. Despite progress in the last decade – thanks to the enactment of the NARAB provisions included in the Gramm-Leach-Bliley Act (GLBA) – the producer licensing system remains duplicative and unnecessarily burdensome, imposing wasteful costs on our members (and their clients – insurance policyholders) in terms of both time and money, with no additional consumer benefits. That is why NAIFA supports the producer licensing reform legislation introduced by Representatives Randy Neugebauer and David Scott. The "NARAB II" bill, as it is commonly called, would create an interstate producer licensing clearinghouse. NARAB II has strong bipartisan support has twice been approved by the Financial Services Committee, and subsequently adopted by the full House of Representatives.

NARAB II builds on a foundation initiated in GLBA over a decade ago. GLBA's NARAB provisions successfully pushed the states to enact producer licensing reforms. In 2000, the NAIC adopted the Producer Licensing Model Act (PLMA), which provides for a system of reciprocal licensing in the states pursuant to the NARAB requirements. The PLMA has been enacted in some form in over 40 states and the District of Columbia.

NAIFA has supported the NAIC's producer licensing reform efforts at every step of the way and we are, in large part, responsible for enactment of the PLMA in the states. NAIFA is a board member of the National Insurance Producer Registry (NIPR), which operates the electronic database of producer information that has made licensing significantly faster and easier, and is an active participant at the national level, working with an NAIC coalition in the development of specific recommendations for achieving true reciprocity and uniformity in producer licensing nationwide.

Although the passage of NARAB gave the states the needed incentive to streamline the insurance producer licensing system, it did not go far enough. Today, there are approximately 40 states that the NAIC has deemed "reciprocal" for NARAB purposes. Although other states have adopted portions of the PLMA, there remain a significant number of states – including major markets such as California and Florida – that are not reciprocal and therefore not in compliance. In addition, reciprocal states sometimes have similar legal requirements but differing standards for licensure – thus creating a patchwork of approaches across the country.

It is clear that without Congressional action, the NAIC will be unable to attain its stated goal of reaching full licensing reciprocity among the states. Indeed, the NAIC has said that their ultimate goal is uniform state licensing requirements. But the states have their own parochial interests and roadblocks to achieving reform, so federal action is necessary.

NAIFA supports the enactment of NARAB II because it would allow insurance producers who are licensed to operate in multiple states to comply with a single set of non-resident licensing and continuing education rules. The need to streamline the non-resident licensing process is important for NAIFA members who relinquish clients when they move to another state because of the burdens imposed by multistate licensing. NAIFA members are in the business of assisting individuals and families address their basic financial security needs and prepare for retirement by helping them secure risk transfer based products such as life insurance, annuities, long-term care insurance, disability income coverage, and medical and hospital insurance. The relationships our members have with their clients are based on a trust developed through years of providing important guidance and assistance in preparing for life's inevitable risks of dying too soon, living too long, becoming sick or disabled or needing long-term care. For many NAIFA members, however, the varying licensing compliance requirements from state-to-state make it unnecessarily burdensome to follow a client to another state when he or she moves. As a result, NAIFA members have to refer their clients to another agent. Enactment of NARAB II is necessary because, in today's increasingly mobile world, it is a disservice to insurance consumers to have a regulatory system in place that makes it difficult for a consumer to retain their trusted agent when they move to another state.

Thank you for your consideration of our views. We appreciate your strong interest in insurance regulatory reform, and look forward to working with you as your efforts advance.

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NAMIC®

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of

Andrew L. Furgatch

Chairman of the Board

Magna Carta Companies

on behalf of the

National Association of Mutual Insurance Companies

to the

House Financial Services Committee

Subcommittee on Insurance, Housing and Community Opportunity

hearing on

Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs

July 28, 2011

The National Association of Mutual Insurance Companies (NAMIC) is pleased to offer comments to the House Financial Services Committee Subcommittee on Insurance, Housing and Community Opportunity on insurance oversight.

My name is Andrew L. Furgatch - Chairman of the Board and CEO of Magna Carta Companies. Magna Carta Companies was founded in New York City in 1925 as a mutual insurance carrier for the taxicab industry. Throughout the decades, Magna Carta has continuously expanded its product offering and underwriting territory. Today, Magna Carta specializes in underwriting the commercial real estate industry and is one of the largest mutual carriers of commercial business in America.

Founded in 1895, NAMIC is the largest full-service national trade association serving the property/casualty insurance industry. NAMIC members are small farm mutual companies, state and regional insurance companies, and large national writers. Its 1,400 member companies write all lines of property/casualty insurance business and account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market.

The Nature of the Property/Casualty Insurance Industry

To begin, it is important to understand that the nature of property/casualty insurance products, the industry's low leverage ratios, its relatively liquid assets, and the lack of concentrations in the marketplace make our industry truly unique within the financial services sector. This uniqueness also makes our business fundamentally different from the other two major components of the insurance business – life insurance and health insurance. The property/casualty insurance industry was not responsible for the recent economic crisis and in fact, the risk that our companies pose to the overall financial system is negligible.

Recent historical evidence supports this claim. Even amid severe financial turmoil, there were no major failures of property/casualty insurers and the industry as a whole greatly outperformed other financial services sectors. Today the industry remains strong, diverse, and vibrant – there are more than 2,700 property/casualty insurers operating in the United States, the majority of which are relatively small. A number of studies over the years, including those conducted by the U.S. Department of Justice, state insurance departments, and respected economists and academics, have consistently concluded that the insurance industry is very competitive under classic economic tests.

Maintaining this robust competition is critical to preserving our industry's ability to provide the foundation of a dynamic economy. Property/casualty insurance is the mechanism that has allowed people to transfer some of the risk of owning property or starting a business and has helped keep the nation's economic engine burning. Artificial suppression of competition through new onerous regulations would not only threaten many of the 533,000 jobs in the industry[1], but it would put additional strain on every other individual and business that requires financial protection from the unknown.

As the subcommittee oversees the implementation of reforms to the regulation of the nation's financial services sector, it is essential to create the optimal structure for all constituents. For the property/casualty insurance industry, these constituents include policyholders, taxpayers, insurance companies, agents, and others affected by the insurance underwriting process. Recognizing the differences in financial services companies and products is essential to preventing "one-size-fits-all" regulation that might conflate property/casualty insurance with banking and unintentionally and unnecessarily damage our industry.

We respectfully urge Congress, and especially this Committee, to carefully monitor the work of federal regulators to ensure that they do not engage in "mission creep" and attempt to regulate outside their legislative mandate. Instead the new regulatory structures should work through the system of state-based insurance regulation, by coordinating and cooperating with state regulators and other functional and prudential regulators.

State Regulation of Property/Casualty Insurance

For over 150 years, property/casualty insurers have been regulated by the states in which they do business. Beginning with the passage of the McCarran-Ferguson Act in 1945, the federal government has officially recognized that the states are the appropriate entities to regulate their own insurance markets. The state-based insurance regulatory system has proven to be adaptable and effective, with rare insolvencies and no taxpayer bailouts. Each state has adopted specific programs and policies tailored to the unique needs of its consumers. State regulators and legislators consider and respond to unique local and regional marketplace conditions, such as risks related to weather, specific economic conditions, medical costs, building codes, and consumer preferences. In addition, state regulators are able to respond and adapt to inconsistencies created by various state contract, tort, and reparation laws.

Much of the reason that the state-based system of regulation has worked is because property/casualty insurance is inherently local in nature. Local accident and theft rates impact pricing. Geographical and demographic differences among states also have a significant impact on property/casualty coverages. Natural disaster perils – hurricanes, earthquakes, etc. – differ significantly from state to state. Additionally, the United States has 54 well-defined jurisdictions, each with its own set of laws and courts. The U.S. system of contract law has deep roots and, with respect to insurance policies, is based on more than a century of policy interpretations by state courts. The tort system, which

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[1] According to the Insurance Information Institute. Note that this number does not include many others such as agents and brokers that could be impacted by policy choices. http://www2.iii.org/firm-foundation/contribution-to-the-national-economy/employment.html.

governs many of the types of incidences at the heart of insurance claims – particularly those covered by liability insurance – is also deeply rooted in state case law pertaining to such things as the law of defamation, professional malpractice, premises liability, state corporation law, and products liability. State and local laws determine coverage and other policy terms and reparation laws affect claims.

With the ability to quickly respond to unique local issues, the individual states serve as a laboratory for experimentation and a launch pad for reform. State-based regulators develop expertise on issues particularly relevant to their state. Insurance consumers directly benefit from state regulators' familiarity with the unique circumstances of their state and the development of consumer assistance programs tailored to local needs and concerns. State regulators, whether directly elected or appointed by elected officials, also have a strong incentive to deal fairly and responsibly with consumers.

Today, it is safe to say that solvency regulation by state regulators has served both policyholders and insurers well. Unlike the regulatory arbitrage and regulator shopping in other financial services sectors that occurred during the lead-up to the financial crisis, insurance products and services remain closely regulated. Insurance supervision adheres to the highest standards of oversight and has contributed to the industry remaining healthy even during difficult economic times.

The state insurance regulatory system, however, is not without its shortcomings. State insurance regulation receives justified criticism for overregulation of prices and forms, lack of uniformity, and protracted speed-to-market issues. We continue to work with state legislators and regulators to address outdated, redundant, and conflicting regulatory policies and procedures and to modernize the insurance regulatory system to meet the needs of a 21st century marketplace.

Dodd-Frank Wall Street Reform and Consumer Protection Act

July 21, 2011, marked the one-year anniversary of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) being signed into law. This legislation was created in response to the financial crisis with the stated purpose of preventing future bank bailouts, corporate bankruptcies, and overextensions – generally, the bill's stated intent was to prevent further financial crises.

Early in the debate, lawmakers recognized both that the property/casualty insurance industry played no part in creating the economic crisis and that our industry remained healthy and solvent throughout. There was a widespread understanding that the state-based regulation of insurance had worked while federal oversight of banks and financial services firms had largely failed.

Although not the cause of the financial crisis, the insurance industry is nevertheless directly and specifically impacted by the overhaul of the nation's financial services regulation found in Dodd-Frank. The Act for the first time creates a Federal Insurance

Office (FIO) specifically tasked with studying the insurance industry. However, Dodd-Frank's application to the insurance industry was not limited to the creation of the FIO. The Financial Stability Oversight Council (FSOC), Consumer Financial Protection Bureau (CFPB) and Office of Financial Research (OFR) will also have a profound impact on the future of the insurance industry. As these offices begin their work and issue regulatory rulemakings, Congress should remain focused on preventing any new duplicative federal regulation of an already heavily regulated insurance industry. Dodd-Frank was meant to address legitimate problems on Wall Street but should not in the process create needless problems on Main Street.

Financial Stability Oversight Council and Systemic Risk

Section 111 of Dodd-Frank established FSOC and subsequent sections tasked it with identifying risks to the financial stability of the United States that could arise from the material financial distress of large, interconnected bank holding companies or nonbank financial companies. This authority includes making recommendations concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management of such institutions.

FSOC also has authority to require supervision by the Federal Reserve Board of Governors for nonbank financial companies that may pose a threat to the financial stability of the United States in the event of their material financial distress or failure. Section 113 establishes a number of criteria for FSOC to consider in making a determination as to whether a particular company should be subject to such supervision.. The Council must consider:

- The extent of the leverage of the company;
- The extent and nature of the off-balance-sheet exposures of the company;
- The extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;
- The importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system;
- The importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;
- The extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;
- The nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
- The degree to which the company is already regulated by 1 or more primary
- financial regulatory agencies;
- The amount and nature of the financial assets of the company; and

- The amount and types of the liabilities of the company, including the degree of reliance on short-term funding.

In making a determination to designate any nonbank financial company as systemically significant and subject to federal consolidated supervision and higher prudential standards, FSOC must consult with the primary financial regulator. In addition, the Council must review and reevaluate any designation on an annual basis.

As it has not been strictly defined, the category of nonbank financial companies ostensibly includes property/casualty insurers. However, the legislative history of Dodd-Frank makes clear that lawmakers generally did not believe that insurers pose a systemic risk. Additionally, many economists agree that the risk the property/casualty industry poses to the overall financial system is negligible. As mentioned above, the industry is highly competitive, well capitalized, and subject to adequate financial and operational regulation. In addition, property/casualty insurers are not as susceptible to the adverse systemic consequences of activities engaged in by banks and other financial institutions that are the principal generators of systemic risk.

In order to understand the relationship between systemic risk and the insurance industry, it is important to understand what is meant by "systemic risk." Systemic risk is often defined as the probability that the failure of one financial market participant to meet its contractual obligations will cause other participants to default on their obligations, leading to a chain of defaults that spreads throughout the entire financial system, and eventually to the nonfinancial economy generally. Another type of systemic risk results from the possibility that a major external event could produce nearly simultaneous, large, adverse effects on most or all of the financial system (rather than just one or a few institutions) such that the entire economy is adversely affected. In this scenario, the threat to the system is a market-oriented crisis rather than an institution-oriented crisis. That is, the crisis occurs because of a widespread event or trend that occurs throughout the financial system, rather than because of the behavior of a particular institution or industry. Market-oriented crises tend to begin with a large change—usually a decline—in the price of a particular asset; the change then becomes self-sustaining over time.

The global financial crisis that began in 2008 was a market-oriented crisis. The financial system broke down not because of a contagion that radiated from one or a few troubled institutions to a host of otherwise healthy entities. What happened instead is that market participants around the world independently speculated that a particular asset class—housing, in this case—would continue indefinitely to increase in value.

Future crises are likely to arise from similar types of asset bubbles and instances of widespread failure by market participants in evaluating certain types of risk. Therefore, regulation that is intended to curtail systemic risk must be carefully designed to address the kind of market-oriented problems that caused the recent crisis and might potentially lead to future crises. The record shows that property/casualty insurers did not cause the last crisis and it is exceedingly unlikely that property/casualty insurers - either individually or collectively - could cause a financial crisis in the future.

Insurance companies and the consumers they serve could be seriously harmed by inappropriate systemic risk regulation that targets individual insurers. We believe that the application of the statutory "considerations" requires the FSOC to take a holistic rather than a formulaic approach to pursuing designations. A holistic or "deeper dive" would include reviewing an institution's culture, risk management practices, and financial strength. A holistic approach also recognizes that while systemic risk determinations are made on an individual basis, there are characteristics of groups of nonbank financial companies that FSOC should take into account in making decisions about whether a particular nonbank financial company should be designated under Section 113.

There are six primary factors that affect the probability that a financial institution will create or facilitate systemic risk: leverage, liquidity, correlation, concentration, sensitivities, and connectedness. A holistic examination of these factors will demonstrate that there is no basis for regulating property/casualty insurance companies for systemic risk because they do not present such a risk. .

Additionally, unlike lightly regulated financial institutions such as investment banks and hedge funds, most of the obligations of property/casualty insurers are protected by the state-based insurance guaranty fund system. This nationwide system, which is financed by the property/casualty insurers of each state, greatly mitigates the effect of any failing property/casualty insurer by providing claimants assurance that the insurer's obligations will be satisfied on a timely basis.

As it is clear that property/casualty insurers pose no systemic risk to the nation's economy or financial structure, efforts to designate them under Section 113 simply by virtue of their classification as financial service providers ignore the underlying business models and financial structure of the industry. There are many other industries more concentrated and interconnected - such as energy, telecommunications, and transportation - that could pose a more serious threat to the nation's economy in the event of failure, than the diverse and financially stable property/casualty insurance industry.

It is imperative that FSOC consider the property/casualty industry in the context of the larger national and global financial services industry and particular companies in the context of the industry as a whole. The Council must resist the temptation to base decisions on size alone or feel compelled to designate an insurer – or group of insurers – simply for the sake of including a representative of all financial industry sectors. Failure of regulators to make the critical distinctions between property/casualty and other financial market participants could result in substantial anti-competitive consequences and increased prices for important consumer financial products, which ultimately hurts consumers without providing any commensurate benefit in protecting U.S. financial stability.

Federal Insurance Office

NAMIC supports a reformed system of state-based insurance regulation and believes that any federal role in insurance should be without regulatory authority. The FIO was a carefully negotiated office that properly recognizes these objectives and must be implemented within this framework. Illinois Department of Insurance Director Michael McRaith was recently named as the first Director of the FIO. Director McRaith officially took over as head of the new office in June 2011 and we look forward to working with him to achieve the goal of developing an information repository and a source of federal expertise on insurance.

Dodd-Frank created the FIO and authorized it to:

- Monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system;
- Monitor the extent to which traditionally underserved communities and consumers, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance;
- Recommend to the Financial Stability Oversight Council that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the Board of Governors;
- Assist the Secretary in administering the Terrorism Insurance Program established in the Department;
- Coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors (or a successor entity) and assisting the Secretary in negotiating covered agreements;
- Determine whether State insurance measures are preempted by covered agreements; and
- Consult with the States (including State insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance.

Lawmakers were careful to ensure that the FIO would not exercise any regulatory or supervisory control and included protections to prevent the office from becoming a *de facto* regulator. The legislation includes explicit language protecting the state-based regulation of insurance and limiting the authority of the FIO to act in a regulatory capacity. Inclusion of this express language recognizes that it is essential to avoid creating a dual regulatory scenario and was critical to the support of the industry in creating the office. As the FIO begins its work, it is imperative that the Office abide by the statutory prohibition against exercising supervisory and regulatory authority over the insurance industry. Congress and this Committee must exercise careful and consistent oversight to guarantee that the application of the FIO's role remains advisory.

Throughout the legislative process, we worked closely with Congress to address our concerns about the FIO. Among those concerns was the power to make data calls and request document productions. Data calls and document requests are costly and time-consuming endeavors for insurers – particularly small insurers with few employees and modest resources. Currently, insurers regularly submit information to state regulators on all aspects of their operations. Creating an additional reporting layer would have gone against the goal of simplification and coordination. There is a need for information on insurance at the federal level, but collecting this information can be achieved by working through the systems and processes already in place.

For these reasons, the authors of the bill saw fit to require the FIO to coordinate with state regulators prior to conducting data calls and limited the office's ability to request information directly from insurers to situations where it is not available elsewhere. Treasury must maintain these important safeguards in implementing this office.

Finally, as part of the mission of the FIO, the director is required to submit several reports to Congress. Beginning on September 30, 2011, the FIO director must submit two annual reports to the President and to the House Financial Services and Senate Banking Committees. The first report will outline any actions taken by the office regarding the preemption of state insurance laws; the second report will examine the insurance industry and any other information deemed relevant by the FIO director or requested by Congressional committees.

In addition to the annual reports, the FIO director is responsible for conducting a study on how to modernize and improve the system of insurance regulation in the United States. This study is due to be released in January 2012.

We are concerned that the FIO may follow the all too common approach of new federal offices and conclude that it requires more resources and authority to oversee the property/casualty insurance industry. This conclusion would be the first step in growing its power and scope and begin to create increased and duplicative federal regulation. We urge that the Committee resist any attempts for the FIO to engage in mission creep and expand beyond its legislative mandate.

Office of Financial Research

Dodd-Frank also created the OFR within the Department of the Treasury. The OFR is charged with improving the quality of financial data available to policymakers and facilitating analysis of the financial system for agencies such as FSOC that monitor systemic risk. To execute these functions, the OFR has two primary operational centers: a Data Center to standardize, validate, and maintain data to help regulators identify vulnerabilities in the financial system as a whole, and a Research and Analysis Center to conduct, coordinate, and sponsor research aimed at improving regulation of financial firms and markets. Specifically, the OFR is tasked with "standardizing the types and formats of data reported and collected" and "developing tools for risk measurement and monitoring." The OFR will conduct financial analysis in support of FSOC, standardize financial reporting requirements, develop a reference database, prioritize making financial data efficient and secure, and produce regular reports to Congress on threats to the financial system and its key research and findings.

Although the goal of the OFR is to standardize data reporting and risk measurement metrics, it is imperative that it recognize the inherent and significant differences between insurance and other financial services sectors when developing these measurement and monitoring systems. For example, comprehensive state regulatory systems for insurance have been developed including detailed investment laws and conservative accounting standards and procedures to access the risk to the underlying entity. State regulations place limits on the amounts of each type of asset that an insurer may hold, as well as the level of concentration in any single investment. State regulations also require insurers to properly value their assets. Securities must be valued according to the rules of the National Association of Insurance Commissioners' (NAIC) Securities Valuation Office, and other invested assets must be valued according to the rules of the NAIC's Financial Condition (E) Committee. In addition, statutory accounting principles (SAP) include the concept of admitted assets -- assets readily convertible into cash. To the extent that a company's investments exceed specified amount limits or fall below specified quality limits, the assets are considered "nonadmitted" and the company is prohibited from taking credit for them on the Annual Statement's balance sheet.

To the extent the OFR and FSOC wish to determine how best to apply the analytical framework to all nonbank financial companies, we suggest not adopting a one-size-fits-all model for all financial institutions, but instead looking to existing insurance regulatory criteria and benchmarks. There are examples of such tools that are currently utilized by insurance regulators. For instance, the NAIC's risk-based capital regulation establishes a uniform standard for capital adequacy and further provides specified levels of regulatory actions for weakly capitalized insurers. Another example is the Insurance Regulatory Information System utilized by state regulators, which consists of a series of 12 financial ratios for which ranges of normal results have been calculated. The ratios focus on critical financial and business conditions, including capital adequacy, changes in business patterns, underwriting results, reserve inadequacy, and asset liquidity. In addition, the NAIC's Financial Solvency Tools system includes other ratios focusing on profitability, asset quality, investment yield, affiliate investments, reserves, reinsurance, liquidity, cash flows, and leverage. These ratios have been developed with careful consideration of the business of insurance and are based on well understood definitions and reflect the more conservative approach to accounting utilized by insurers pursuant to SAP. These tools provide a clear and accurate picture of an insurer's size, degree of leverage, and liquidity risk.

Early on, we expressed concern that the OFR's activities could potentially conflict with the work of the FIO and state insurance regulators. Although the property/casualty insurance industry will not be a likely focus for systemic risk information gathering, we remain concerned about the potential for duplicative information gathering and collection requirements placed on insurers. The OFR and the FIO must be required to coordinate to acquire any information from publicly available sources to prevent duplication (or even triplication) of efforts. Certain safeguards were written into Dodd-Frank to prevent these conflicts; however, the potential exists for the office to grow beyond its scope as an information clearinghouse for FSOC and Congress.

Consumer Financial Protection Bureau

The creation of a new, independent federal financial consumer protection agency was the centerpiece of the Obama Administration's financial services regulatory reform package released in the summer of 2009. The CFPB was included in Dodd-Frank and is charged with overseeing all consumer protection rulemaking and regulations with regard to consumer financial products and services.

Insurance products are already well regulated at the state level for protecting consumers. Both the administration and Congress recognized this fact and ultimately all lines of insurance were properly excluded from the office. However, as with any new office of this size and scope, it is possible that regulatory overreach could drag insurance back into CFPB jurisdiction.

Although the business of insurance was specifically excluded from the scope of the CFPB, this large new bureaucracy promises to be far-reaching and could impact insurance in many ways. For example, Dodd-Frank transfers oversight of provisions of the Fair Credit Reporting Act and other privacy laws to the CFPB. In addition, the CFPB has created a new consumer complaint database and on March 9, 2011, the CFPB issued a request for comments on the new office's information and complaint collection activities. As part of its activities, CFPB must collect and respond to various complaints regarding financial products and services.

While insurance is excluded from its jurisdiction, and is not specifically mentioned in the request for comments, the acting head of the agency, Elizabeth Warren, has informed the Committee that the CFPB has received insurance related complaints. We are concerned about the agency's inappropriate and unauthorized involvement in insurance-related complaints. We have specifically asked the CFPB to implement procedures that would directly refer such complaints to the appropriate state regulator without retaining information in the federal database. Failure to implement a firewall between insurance and non-insurance complaints would violate the statutory prohibition on involvement in the business of insurance and may require a legislative fix.

The House of Representatives has already demonstrated a commitment to ensuring that the CFPB should be an accountable and transparent agency by passing H.R. 1315, the Consumer Financial Protection Safety and Soundness Improvement Act of 2011. Among other things, the bill establishes a five-member, bipartisan commission to manage the CFPB instead of a single administrator; creates a meaningful review process that takes into consideration how a proposed rule could endanger the safety of financial institutions; and ensures that there is a Senate confirmed chair of the commission before the Bureau exercises any new regulatory authority. We were also encouraged by an amendment offered by Rep. Erik Paulsen that gives power to the nonvoting insurance representatives on FSOC to petition CFPB decisions. In addition, this amendment served to remind the CFPB that insurance was not included in its jurisdiction.

As implementation of Dodd-Frank goes forward Congress must remain vigilant so that the agency does not exceed its mandated authority.

Volcker Rule

Section 619(a) of Dodd-Frank (the "Volker Rule") prohibits banking entities from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds. Further, Dodd-Frank also mandates that FSOC study and make recommendations on implementing the Volcker Rule so as to "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system."

Insurers collect premiums from customers in return for a promise to pay on a potential future claim. Those premium dollars are invested by the insurer to ensure that those future claims are able to be paid. Eliminating the ability to invest these premiums beyond low-yield government securities would create the need to charge higher premiums on policies for consumers. Furthermore, there already exists a strong state-based insurance investment regulatory system, which serves to protect the safety and soundness of those insurance institutions containing a banking entity.

Investment limitations imposed upon property/casualty insurers structured as mutual thrift holding companies would have the unintended consequence of severely restricting investment options, including ones that involve minimal risk. State insurance investment laws impose strict limits on the types of investments that property/casualty insurance companies may utilize from both a qualitative and quantitative standpoint. The general aim of the state insurance investment laws is to protect the safety and soundness of the insurance institution while also protecting the interests of customers by promoting insurer solvency and financial strength.

With these considerations in mind, Congress recognized the importance of appropriately accommodating the business of insurance by providing an exemption from the Volcker Rule for an insurance company acting on behalf of its general account. Therefore, Section 619(d)(1)(F) provides that, notwithstanding the prohibitions of Section 619(a), investing in "securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company" is a permitted activity.

Congress realized that application of the Volker Rule to insurance companies would prevent an insurance company from making properly diversified and allocated investments to support their insurance operations and to meet their customers' needs. Insurers investment practices should not be restricted in such a way that they could no longer pursue their long-established basic business models. These core insurer investment practices did not pose a significant risk to the national economy during the recent economic crisis and will not create systemic risk to the economy in the future.

In order to further protect fundamental insurance investment practices, the FSOC study should recommend that the current insurance regulatory system be recognized as proper and effective protection for the safety and soundness of any banking entity within an insurance institution as well as the United States financial system as a whole. By allowing insurers to continue in their normal regulated investment activity from their general account - including engaging in proprietary trading and ownership of interest in securities such as private equity and hedge funds - the FSOC study would comply with legislative intent that clearly meant to preserve this system and exclude the insurance company investment model from application of the Volcker Rule.

The most effective way to appropriately accommodate the business of insurance while also protecting the safety and soundness of a banking entity subsidiary of an insurance company is to recognize the protections afforded by state regulatory insurance laws and ensure that the permitted activity in the Volcker Rule applicable to insurance companies by Section 619(d)(1)(F) of Dodd-Frank is implemented so as not to restrict an insurance company from making investments in compliance with such laws.

Savings and Loan Holding Companies

Under Dodd-Frank, the Federal Reserve assumed regulatory authority over savings and loan holding companies (SLHCs) from the now defunct Office of Thrift Supervision. For many SLHC s, insurance is the dominant economic activity, while banking-related activities may be minimal in the entire holding company structure. There are fundamental and inherent differences between insurance and banking and it is imperative that the regulatory approach not simply graft a bank-centric Bank Holding Company structure onto SLHS.

Understandably, the Fed's regulatory approach to holding companies is bank-centric. Thus it may appear to be more efficient to simply graft its bank holding company regulatory regime onto SLHCs, As the regulatory process moves forward we urge the Committee to ensure that the Federal Reserve works closely with the FIO, state regulators, and industry to ensure that regulatory standards and metrics to reflect the economic reality that insurance dominated SLHCs have different prudential regulatory concerns than BHCs. Specifically, Section 171 of Dodd-Frank (the Collins Amendment) imposes minimum regulatory and maximum leverage requirements on depository institution HCs. However, comparing bank capital and insurance capital for regulatory purposes is like comparing apples to pizza—and the requirements of the Collins Amendment are entirely bank-centric.

In addition, many insurance companies rely on insurance statutory accounting principles, while banking regulators generally require GAAP, and we believe it is appropriate to allow those insurers to continue using SAP, particularly those whose structure (i.e., nonpublic and mutual insurers) does not otherwise require the use of GAAP.

These are just two examples of the many areas in which regulators will need to work closely with insurance regulators to ensure proper functioning of insurance markets and avoid duplicative and conflicting regulation.

International Insurance Agreements on Prudential Measures

NAMIC believes increased coordination and cooperation among international regulatory authorities is desirable, but we question the notion that the current system imposes an inappropriate or undue impediment to participation in U.S. markets by non-U.S. insurers. Movement of capital that is intended for risk or insurance generally flows freely at present. Coordination of reporting or presentation standards to permit review and evaluation help to foster greater regulatory transparency and encourage competition. Present cooperation between the European Union and U.S. provide a sound basis for further collaborative efforts.

As a part of these efforts, U.S. insurance regulators – through the NAIC – participate in the International Association of Insurance Supervisors (IAIS). The IAIS develops international standards for insurance supervision, provides training to its members, and fosters cooperation between insurance regulators, as well as forging dialogue between insurance regulators and regulators in other financial and international sectors. Regulators and staff participate in the work of the IAIS on a variety of issues including international solvency supervision, accounting standards, and reinsurance regulation, among others.

The FIO is empowered to coordinate federal efforts and establish federal policy on prudential aspects of international insurance matters, including representing the United States as appropriate in the IAIS and assisting the Secretary of the Treasury in negotiating International Insurance Agreements on Prudential Measures.

We support enhanced cooperation and coordination among the various global financial services regulatory bodies. However, such cooperation and coordination should not come at the cost of abdication of regulatory authority to foreign jurisdictions or quasi-governmental bodies. Likewise, authority to enter into agreements and bind U.S. insurers and insurance regulators should not depend solely on the discretion of the Secretary of the Treasury.

International agreements affecting insurance must be negotiated in full coordination with state regulators and Congress must not abandon its oversight function and should exercise full consultative authority. Furthermore, these agreements need to be reconciled against the realities of the US insurance market. Significant differences exist between the U.S. regulatory structure and the regulatory scheme in other countries. For instance, most European countries do not regulate the price of insurance products whereas we have common price regulation in the U.S. Also, our tort environment is very different from most other countries; these realities must be considered and reconciled with any international agreement under negotiation.

Conclusion

In the wake of Dodd-Frank, it is important that Congress continue to recognize the health and success of the property/casualty insurance industry. Congress must be vigilant in its oversight of Dodd-Frank implementation to ensure that federal regulators resist the temptation to lump the property/casualty industry into a single "financial services" basket and feel compelled to designate insurers as systemically significant simply for the sake of including representatives of all sectors of the financial services industry. Lawmakers appropriately recognized that the insurance industry does not pose systemic risk to the economy, and we urge Congress to carefully monitor the work of federal regulators to ensure that the industry is not inappropriately swept into the Dodd-Frank regulatory framework.

The Committee must also remain ever vigilant regarding the impact of international standard-setting organizations and intergovernmental bodies on U.S. insurance regulation. State-based insurance legislators and regulators should determine insurance standards, not federal agencies or international bodies. The costs of multiple regulations that could result from overlapping, duplicative, or conflicting standards could harm the marketplace for consumers and industry alike. We urge the Committee to work with state legislators and regulators, industry, the FIO, and trade negotiators to protect and preserve the state-based regulatory system that has served our nation's insurance consumers well for decades.

NCOIL

National Conference of Insurance Legislators

...for the states

July 29, 2011

Representative Judy Biggert, Chair
U.S. House Committee on Financial Services
Subcommittee on Insurance, Housing & Community Opportunity
2113 Rayburn House Office Building
Washington, DC 20515

Dear Chairperson Biggert:

As president of the National Conference of Insurance Legislators, I would like to further respond to your question at yesterday's hearing entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs" regarding the possibility of NCOIL and the National Association of Insurance Commissioners (NAIC) reaching common ground on the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT).

In line with NCOIL Treasurer Rep. Greg Wren's remarks, NCOIL will recommit its efforts with the NAIC to find a unified response to surplus lines reform. NCOIL repeatedly, and to no avail, tried to develop a joint approach with the NAIC early on in SLIMPACT development—asking for input on compact provisions with the promise to modify in order to gain NAIC support. Responding to regulator concerns that SLIMPACT was overly prescriptive, the compact language was substantially slimmed down by deleting certain uniform standards.

NCOIL will again reach out to the NAIC to ask their buy-in to SLIMPACT, as our state legislators believe its uniform standards respond to NRRA intent to simplify and streamline the surplus lines regulatory process and meet the state constitutional concerns expressed by compact legal experts. We believe SLIMPACT is honing in on an allocation method upon which all interested parties, including the NAIC, can agree.

SLIMPACT uniform foreign eligibility requirements will prohibit undercapitalized foreign insurers from selling surplus lines insurance to state insurance consumers. The SLIMPACT uniform policyholder notice will ease the costly administrative burdens tied to issuing up to 51 different state-mandated policyholder notices.

NCOIL believes only SLIMPACT meets the criteria established in the NRRA, and will provide uniformity, simplicity, relative revenue neutrality, etc., for the states. Industry worked on and supported the development of the SLIMPACT model and is not supportive of the NIMA model.

In summary, NCOIL will make every effort to work with the NAIC to achieve synergy while maintaining our full-faith effort to respond to Congress's desire to unburden and streamline the surplus lines regulatory system. We look forward to further communications with your Subcommittee in the near future to apprise you of our efforts.

Best regards,

George Keiser

Rep. George Keiser (ND)
NCOIL President

cc: U.S. House Financial Services Committee
U.S. Senate Banking Committee

K;NCOIL/2011 Docs/2007417

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NCOIL
National Conference of Insurance Legislators
...for the states

July 29, 2011

Commissioner Susan Voss
NAIC President
Iowa Division of Insurance
330 Maple Street
Des Moines, Iowa 50319

Dear Commissioner Voss:

As president of the National Conference of Insurance Legislators—and in line with NCOIL Treasurer Rep. Greg Wren's remarks yesterday at the U.S. House Committee on Financial Services Subcommittee on Insurance, Housing and Community Opportunity's hearing—I am writing you in an effort for our mutual organizations to reach common ground on surplus lines regulatory reform.

Because Congresswoman Biggert has suggested that the NAIC work with NCOIL on SLIMPACT as a unified response to the NRRA, NCOIL is asking you, as we did early on in SLIMPACT development, to find a common ground in SLIMPACT. As you can remember, responding to regulator concerns that SLIMPACT was overly prescriptive, NCOIL slimmed down SLIMPACT language by deleting certain uniform standards. Another concern expressed by NAIC regulators that SLIMPACT would not be functional soon enough has been put to bed—as SLIMPACT has nine members and counting.

Commission representatives have developed bylaws and a rule for rulemaking, and are now honing in on an allocation method upon which all interested parties, including the NAIC, can agree. The Counsel of State Government (CSG) has offered its renowned National Center for Interstate Compacts as a means of housing and facilitating SLIMPACT Commission operations.

The compact's uniform standards respond to NRRA intent to simplify and streamline the surplus lines regulatory process and protect the surplus lines consumers in our states. SLIMPACT uniform foreign eligibility requirements will prohibit undercapitalized foreign insurers from selling surplus lines insurance to state insurance consumers. The SLIMPACT uniform policyholder notice will ease the costly administrative burdens tied to issuing up to 51 different state-mandated policyholder notices.

As promised by Rep. Wren yesterday, NCOIL will make every effort to work with the NAIC to achieve synergy in responding to Congress's desire to unburden and streamline the surplus lines regulatory system. We look forward to your response and to further communications with the NAIC in the near future. We would like to go back to Congress in or before its fall hearing with good news about state surplus lines regulatory reform.

Best regards,

George Keiser

Rep. George Keiser (ND)
NCOIL President

cc: NAIC Regulators
U.S. House Financial Services Committee
U.S. Senate Banking Committee
NCOIL Legislators

K;NCOIL/2011 Docs/2007425

NCOIL

National Conference of Insurance Legislators

...for the states

August 1, 2011

Representative Judy Biggert, Chair
U.S. House Committee on Financial Services
Subcommittee on Insurance, Housing & Community Opportunity
2113 Rayburn House Office Building
Washington, DC 20515

Dear Chairperson Biggert:

Thank you again for inviting me to testify at last week's hearing entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs." As NCOIL Treasurer—and with the endorsement of the NCOIL President—I would like to further respond to your question about delaying the effective date of *Nonadmitted and Reinsurance Reform Act* surplus lines tax provisions. NCOIL would strongly support your sponsorship on legislation extending the effective date from July 21, 2011, by at least one year until July 21, 2012, and would appreciate your leadership on the issue.

As I reported to the Subcommittee, the states have made tremendous progress on a *Surplus Lines Insurance Multi-State Compliance Compact* (SLIMPACT). However, due to abbreviated legislative calendars and the quick turn-around time afforded by the Dodd-Frank Act, some states were not able to join SLIMPACT in 2011. We believe that significantly more states would join SLIMPACT—nationally advancing the modernization that Congress envisioned under the NRRA—if Congress granted our states an additional 12 months to coordinate the payment of surplus lines premium taxes on multi-state risks.

Legislation to extend the effective date would need to amend the surplus lines segment of the NRRA—Title V, Subtitle B, Part I. Specifically, Section 512 could be amended as follows:

> *Except as otherwise specifically provided in this subtitle, this subtitle shall take effect upon the expiration of the 12-month period beginning on the date of the enactment of this subtitle.* ***Part I, Section 521, of this subtitle shall take effect upon the expiration of the 24-month period beginning on the date of the enactment of this subtitle.***

The effect of such language would be to delay only the tax provisions of the NRRA. The change would not impact NRRA provisions regarding surplus lines placement, eligibility, or broker licensing. Nor would it impact NRRA reinsurance sections. Simply put, it would allow states to continue collecting surplus lines taxes for another year in the same manner that they collected the taxes as of two weeks ago.

NCOIL appreciates your willingness to consider modifying the Dodd-Frank Act for the benefit of states, consumers, and businesses. We are hopeful that you will consider extending the effective date of NRRA tax provisions, and we stand ready to assist you in any way possible.

Best regards,

Greg Wren

Rep. Greg Wren(AL)
NCOIL Treasurer

cc: Chairman Spencer Bachus, U.S. House Committee on Financial Services
Members, U.S. House Financial Services Committee
Chairman Tim Johnson, U.S. Senate Banking Committee

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Ranking Member Richard Shelby, U.S. Senate Banking Committee
Larry Lavendar
NCOIL Executive Committee

NCOIL/2011/2007426

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Letha Heaton
President

Richard Bouhan
Executive Director

Honorable Robert Dold
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

September 12, 2011

Dear Representative Dold and Committee Members:

Thank you for passing along the below question as a follow up to the July 28, 2011 hearing, entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs":

> In passing the NRRA, Congress tried to establish a uniform and efficient regulatory system to improve the market for brokers and consumers. Through your role at NAPSLO, what have you heard from the front-line brokers and other professionals about whether this congressional intent has been effectively implemented?

As President of NAPSLO, a trade association representing both surplus lines brokers and companies, I appreciate the Committee's continued interest in facilitating effective and efficient implementation of the *Nonadmitted and Reinsurance Reform Act* (NRRA) in a manner consistent with Congressional intent.

My colleagues at NAPSLO and I have received feedback from various segments of the industry regarding the post-NRRA regulatory system and environment. The current industry sentiment is that uniformity and efficiency *has not* been achieved with respect to the allocation and payment of surplus lines premium taxes on multi-state risks, one of the primary goals of the NRRA. Industry folks, however, are generally satisfied with the implementation of some of the other reforms mandated by the NRRA (e.g., broker licensing and eligibility requirements).

The process of developing a streamlined and uniform approach to the allocation and payment of surplus lines premium tax on multi-state risks is essential to realizing the intent of the NRRA. Competing tax compacts referred to as SLIMPACT[1] and NIMA[2] have given rise to the possibility of two separate approaches to multi-state premium tax allocation: (1) an allocation methodology proposed by the Kentucky Department of Insurance (the Kentucky proposal), as supported by SLIMPACT; and (2) an undetermined allocation methodology, to be selected by NIMA. States have aligned with either of SLIMPACT or NIMA, or have chosen not to align with any tax compact. As such, uniformity has not been

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[1] SLIMPACT is the acronym for the Surplus Lines Insurance Multistate Compliance Compact, which is supported by NCOIL and other industry associations.
[2] NIMA is the acronym for the Nonadmitted Insurance Multistate Agreement, which is supported primarily by the NAIC.

achieved in the current regulatory regime. Agreement among the tax compacts on an allocation methodology is the first step toward achieving the intent of the NRRA.

A number of insurance commissioners, insurance legislators, industry trade associations, brokers and companies have rallied in support of the Kentucky proposal, which would provide uniformity and simplicity by incorporating an allocation methodology based on readily available data. Signatories to a Joint Letter in support of this proposal include the American Association of Managing General Agents (AAMGA), American Bankers Insurance Association (ABIA), American Insurance Association (AIA), California Insurance Wholesalers Association (CIWA), Council of Insurance Agents & Brokers (CIAB), Independent Insurance Agents & Brokers of America (IIABA), National Association of Mutual Insurance Companies (NAMIC), National Association of Professional Surplus Lines Offices (NAPSLO), and The Risk and Insurance Management Society, Inc. (RIMS).

NAPSLO and other industry representatives are working tirelessly with interested parties to urge the NAIC to adopt the Kentucky proposal, in an effort to harmonize the allocation scheme between the two compacting tax compacts, and move closer to achieving Congress's goals of uniformity and simplicity in the surplus lines marketplace.

We urge the Committee to continue monitoring the situation and invite any additional questions.

Best regards,

Letha Heaton,
NAPSLO President

July 28, 2011 Hearing

Questions from Representative Dold

Panel 2:

- **<u>For Mr. Jackson</u>:** How is your agency hindered by the licensing process that you must currently follow, and how in your opinion could the NARAB II legislation help small businesses like yours and the consumers that you serve?

Response:

"Like many other insurance producers, oftentimes we need multiple licenses (both for individual agents/brokers and an entity license for the business) to handle a single, multi-state insurance transaction. Complying with distinct licensing and license renewal requirements in multiple states is both time-consuming and expensive. The NARAB Reform Act would simplify the licensing and renewal process for multi-state producers and agencies by reforming the non-resident licensing process and encourage states to issue and renew licenses on a reciprocal basis.
Removing these administrative burdens not only help insurance agents but will also increase competition in the market and consumer choice."

UNITED STATE HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY
"INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR U.S. CONSUMERS, BUSINESSES AND JOBS"
JULY 28, 2011

RESPONSES OF LEIGH ANN PUSEY (PRESIDENT & CEO, AMERICAN INSURANCE ASSOCIATION) TO QUESTIONS POSED BY REPRESENTATIVE DOLD

Is insurance systemically risky? What is the most effective way to refute the assumption that any insurer is too big to fail?

No. Insurance is not systemically risky, and property-casualty insurance companies that are engaged in traditional insurance activities do not present the type of risk that poses a threat to the financial instability of our nation. The most effective way to refute the assumption that any insurer is "too big to fail" is not to focus primarily on the consolidated asset size of the company (i.e., the extent to which the insurer is a "big" company), but rather to also examine the following interrelated criteria in descending order of importance: (a) the nature of the industry in which the firm participates and its activities and business model; (b) the degree to which those activities are regulated at the state or federal level; (c) the level of competition in the industry, the number of competitors, and the extent to which other companies can provide equivalent products or services should the company fail; and (d) the "interconnectedness" of a company to other financial sectors and institutions, particularly as a source of credit and liquidity. By all these measures, the property-casualty insurance industry – which comprises the AIA's membership – presents little, if any, systemic risk.

Our conclusion that property-casualty insurance does not pose systemic risk starts with the industry business model. Insurance companies operate under a different business model than other financial firms, based on an "inverted cycle of production"[1] where premiums are received up-front. "This means that the product - the contractual promise to pay an agreed amount only if a particular event occurs in the future - is sold at a price, the insurance premium, which has to be estimated before knowing the actual cost of the product which depends on probabilities of occurrence and severity of future events."[2] The property-casualty industry business model is premised upon collecting sufficient premium in advance from each customer to fund likely covered claims from all similarly situated customers. Hence, there is less need to borrow and consequently a lower likelihood of becoming highly leveraged. When insurance companies do borrow,

[1] "Systemic Risk and the Insurance Sector," International Association of Insurance Supervisors, p. 2 (IAIS Paper) (Oct. 25, 2009).

[2] IAIS Paper at 2.

they generally do so through the issuance of long-term debt or surplus notes in the public and sometimes private placement markets, for the purpose of long-term strategic positioning. They do not continuously tap very short-term funding vehicles such as commercial paper issuance for their day-to-day funding requirements. In short, the nature of the insurance business itself – which requires sufficient capital on hand to pay anticipated, but unknown losses covered by contract - promotes increased financial stability.

The primary risks for insurance firms are underwriting and market risks. With regard to market risks, insurance assets and liabilities are generally linked, and risks are comparatively longer term and more diversified than in sectors such as banking. Relevant types of risks pooled are typically "real events" such as theft, fire, sickness, death and natural hazards. These are exogenous events and mostly independent in nature, as opposed to other types of financial risk.

The insurance business model also helps shield property-casualty insurers from the so-called "run on the bank" scenario frequently used to describe the contagion effect of systemic risk. Unlike customer deposits held by banks, payment of insurance policy claims depends on the occurrence of a covered event. Therefore, as a practical matter, insurance consumers do not have "on-demand" access to insurance assets as they do with other financial institutions that do not operate according to an inverted cycle of production.

Not even extreme disasters such as a major hurricane will produce a systemic risk on the part of any property-casualty insurer. Our consistent experience with these types of mass catastrophes is that the crisis is short-lived because additional capacity is promptly supplied by new market entrants due to the lower barriers to entry for property-casualty insurance (as was the case with property insurance capacity following Hurricanes Andrew and Katrina).[3] Perhaps most importantly, natural catastrophes and other extreme insured events have little or no correlation to the stability of the broader financial markets, suggesting the absence of any interconnectedness.

In addition to aiding a rapid response to any capacity shortages, the competitive market structure in property-casualty insurance further reduces the possibility that any individual company could be a source of systemic risk. There are thousands of property-casualty insurers operating in the United States. According to the most recently

[3] Following Hurricane Katrina, Ariel Reinsurance Ltd. commenced operations with an initial focus on property catastrophe excess coverage with $1 billion of equity capital. *See, e.g.*, http://www.arielhosted.com/downloads/media/ArielRe_181205.pdf. With respect to man-made catastrophes such as terrorism that have different insurability characteristics, the capacity response has involved both federal legislation (the Terrorism Risk Insurance Act and its two legislative extensions of the program) and the private market. For example, with respect to the latter, AXIS Capital commenced operations in late 2001, with approximately $1.7 billion available to provide terrorism risk insurance. *See* http://www.axiscapital.com

available data from A.M. Best based on insurer 2010 Annual Statements filed with the National Association of Insurance Commissioners ("NAIC"), there were 361 homeowners insurers, 305 personal automobile liability insurers, 338 commercial automobile liability insurers, 276 workers' compensation insurers, 333 commercial multi-peril (non-liability) insurers, and 291 commercial liability insurers writing those lines of business in the United States. None of these lines was considered to be even moderately concentrated when applying a traditional Herfindahl-Hirschman Index ("HHI") concentration analysis (with an HHI of 1800 considered to be concentrated).[4]

Even if a so-called "large" property-casualty insurer failed and no longer wrote business in these major lines, based on the number of competing companies and lack of market concentration in those lines, there would be no capacity shortage or substantial market disruption because other insurers would be in a position to step in promptly and provide insurance protection for those policyholders. Indeed, competition within the property-casualty industry remains vigorous. Even at the height of the global financial crisis and accompanying decline in asset values, property-casualty insurers remained well-capitalized by any historical measure. A review of year-end surplus levels shows that the property-casualty sector continued its robust recovery from the modest recessionary dip of 2007-2008 with regulatory capital (surplus) increasing by 18.2% in 2010 to $580.5 billion.[5] To illustrate the financial strength and capacity of property-casualty insurance, we note that insurance regulators raise red flags when premium to surplus ratios exceed 3 to 1. With a 2010 surplus of $580.5 billion and aggregate net written premiums of approximately of $430.1 billion,[6] the property-casualty insurance industry currently is operating at a ratio of 0.74 – well within the financial adequacy comfort zone.

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[4] In 1982, the Antitrust Division of the U.S. Department of Justice adopted specific guidelines for challenging mergers based on the Herfindahl-Hirschman Index (HHI) of market concentration. The HHI takes into account the market share of *each* firm in an industry. The HHI has since gained wide acceptance as the public and private sector standard for measuring market concentration and assessing the competitiveness of markets.

The HHI is calculated by squaring the percentage market share of each firm in the industry and then adding those squares. For example, in an industry with only 3 firms, the HHI would be calculated as follows: HHI = $(\text{market share of firm } 1)^2 + (\text{market share of firm } 2)^2 + (\text{market share of firm } 3)^2$. In an industry consisting of 100 firms, each with an equal share of the market, the HHI would equal 100. In an industry with one firm, a pure monopoly, the HHI would equal 10,000 (or 100^2). Thus, the index is smaller the more firms there are in the industry and the more equitable the distribution of market shares between firms. In general, markets with an HHI of 1,000 or less are considered relatively unconcentrated, whereas markets with an HHI of 1,800 or greater are considered highly concentrated. (If an industry has an HHI value between 1,000 and 1,800, the Justice Department will challenge any merger that increases the HHI by at least 100 points).

[5] "Financial and Market Conditions," Insurance Information Institute (August 2011) (http://www.iii.org/issues_updates/financial-and-market-conditions.html).

[6] Best's Aggregates & Averages, Property/Casualty, United States & Canada (2011 edition).

The financial regulatory standards and metrics in place for property-casualty insurers underscore the financial strength of the property-casualty insurance sector and the soundness of its business model. Regulators supervise operating insurance companies in a manner that ensures that they will always be in a position to meet their obligations to policyholders. Foremost among regulatory requirements is the risk-based capital ("RBC") standard, which imposes capital requirements on property-casualty insurers based on the various risks that an insurer undertakes (e.g., underwriting risks, investment risks, credit risks, etc.). Additionally, regulators use certain metrics developed by the NAIC as an early warning system to identify insurers that may become financially weak. The NAIC's Insurance Regulatory Information System ("IRIS") measures insurers' financial condition, using IRIS ratios that test a company's leverage, liquidity, and ability to meet obligations as they come due. We have attached a list and description of the IRIS ratios used for property-casualty insurance companies for your information.

Equally important, capital and regulatory penalties discourage risky financial behavior and excessive leverage by property-casualty insurance companies. Regulatory capital supports new underwriting activity, but additional debt reduces capital surplus available for additional underwriting. A capital penalty is imposed for secured and unsecured borrowing in determining the insurer's RBC requirement. This penalty takes the form of an RBC charge on the insurer's unsecured debt, resulting in a higher capital requirement for a company. Moreover, under statutory accounting principles, assets that are pledged as collateral are deemed to be non-admitted, i.e., the pledged asset is not counted for purposes of determining regulatory capital.

State laws also place restrictions on insurer borrowings or may require regulatory approval for material financing transactions, underscoring both the carefully designed insurance regulatory system and the regulatory, legal, and capital brakes that guard against excessive leverage.

Property-casualty insurers maintain conservative investment portfolios that align with the business model and are in compliance with financial regulations that limit the types and concentrations of investments that insurers may hold. In 2010, and consistently over the past decades, approximately two-thirds of property-casualty investments were in investment grade bonds, with a significant portion in government bonds. Another 17% of investments were in blue chip common and preferred stock, whereas only 0.7% of property-casualty investments were in real estate.[7]

[7] "Financial and Market Conditions," Insurance Information Institute (August 2011) (http://www.iii.org/issues_updates/financial-and-market-conditions.html).

While current financial regulatory standards ensure that property-casualty companies maintain the capital necessary to pay claims when they come due, state-based insurance guaranty funds provide the financial backstop in the event a property-casualty insurer is unable to meet its financial obligations to its policyholders. As noted above, states maintain rigorous capital standards for property-casualty insurers that effectively penalize companies from becoming highly-leveraged. Guaranty associations funded by competing private insurance companies both encourage the maintenance of sound financial condition and limit the moral hazard that might otherwise be generated by an (implicit or explicit) governmental mechanism.

All these elements – from the business model to the market structure to the nature of the financial regulatory system and its emphasis – combine to virtually eliminate the potential for a property-casualty insurer engaged in ordinary insurance activities to be a risk to the financial stability of the United States. There are numerous studies that have come to the same conclusion.[8]

Equally important, the structure of the Dodd-Frank Act itself is consistent with the conclusion that property-casualty insurers engaged in insurance activities do not present systemic risk. Property-casualty insurers are subject to a state-based resolution mechanism that rehabilitates or liquidates carriers that are placed in receivership. The guaranty fund system previously described supports this mechanism, ensuring that covered claims will be satisfied even in the event of financial insolvency. Title II of the Dodd-Frank Act establishes an alternative resolution system administered by the Federal Deposit Insurance Corporation for those distressed financial companies that have been determined to be systemically important. This resolution alternative was established because existing bankruptcy mechanisms did not provide an appropriate way to liquidate systemically important companies in an orderly fashion. Importantly, Title II exempts insurance companies (both those that would otherwise be considered "covered" under Title II and insurance subsidiaries of significant financial services firms) from the FDIC orderly liquidation authority in deference to the state-based system.[9] As a result, Congress has made a judgment that the liquidation of an insurer according to the state-based process is sufficient and does not present a systemic threat that would require the application of Title II's orderly resolution standards.

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[8] Marian Bell and Benno Keller, Insurance and Stability: The Reform of Insurance Regulation (Zurich, Switzerland: Zurich Financial Services Group 2009); CEA, Insurers of Europe, Insurance: A Unique Sector – Why Insurers Differ From Banks (Brussels, Belgium 2010); Group of Thirty, Reinsurance and International Financial Markets (Washington, D.C. 2006); International Association of Insurance Supervisors (IAIS), Systemic Risk and the Insurance Sector (Basel, Switzerland 2009); Swiss Re, Reinsurance – A Systemic Risk?, Sigma No. 5/2003 (Zurich, Switzerland 2003); J. David Cummins and Mary Weiss, "Systemic Risk and the U.S. Insurance Sector," Department of Risk, Insurance and Healthcare Management, Temple University (Sept. 14, 2010).

[9] Dodd-Frank Act § 203(e).

Major insurance insolvencies both here and abroad reinforce Congressional judgment that property-casualty insurance companies do not pose a systemic risk that requires creation of a liquidation alternative in the United States to make certain that the resolution process is orderly. Some observers pointed to the March 2001 collapse of Australian insurance giant HIH Insurance Group as a prime example of insurance systemic risk. Yet, careful examination of the aftermath of the HIH failure demonstrates that it produced only temporary disruption in Australian insurance markets, not an abrupt and cascading effect on other financial sectors and the larger economy. In part, this limited impact was due to the insurance business model, the easy substitutability of the products provided by HIH, and the capacity of the insurance industry to aid "in the resolution of the temporary imbalances that usually occur when a large insurance player exits the market suddenly."[10] Because of the universal conclusion that the HIH failure was a result of poor internal business practices and corporate governance, it did, however, provide the Australian government with an opportunity to accelerate regulatory reforms that were already underway.

Closer to home, the Reliance insolvency in the United States demonstrated that the U.S. property-casualty industry and regulatory structure were easily capable of handling the failure of a major company, and that the state-based guaranty fund system worked well in handling any remaining claims with respect to Reliance insurance policies. Reliance was the largest ever U.S. property-casualty insurer liquidation.[11] State guaranty associations have made $2.8 billion in claim payments and have reported reserves of $1.1 billion.[12] Despite the size of the liquidation and the amount of claim payments, the Reliance liquidation proceeded in an orderly, rational fashion. Policyholders and third-party claimants were paid in a timely and appropriate manner without the time delays and reduced payments often occasioned by bankruptcy proceedings. As the Reliance liquidator stated, "The [guaranty associations] are an essential part of the liquidation safety net, providing significant coverage to certain policyholders and paying covered claims as defined and required by their respective statutes."[13] The liquidator further noted that the guaranty associations and the liquidator "established a close working relationship and will continue to address the extensive and complex issues involved in the Reliance Estate in a professional, mutually cooperative and beneficial manner."[14]

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[10] Etti Baranoff, "Systemic Risk vs. the 10-Year Old Insurance Failure in Australia," Insurance and Finance No. 8, The Geneva Association, at p. 3 (Aug. 2011); *see also* Michael Wilkins, "HIH: Systemic Risk or Opportunity?" Insurance and Finance No. 8, The Geneva Association (Aug. 2011).

[11] Quarterly Report of the Liquidator on the Status of the Liquidation of Reliance Insurance Company, *In Re Reliance Insurance Company in Liquidation*, No. 1 REL 2001, at 14 (PA Commw. Ct. June 24, 2011).

[12] Quarterly Report of the Reliance Liquidator, p. 3.

[13] Quarterly Report of the Reliance Liquidator, p. 14.

[14] Quarterly Report of the Reliance Liquidator, p. 15.

We believe that the factors described above, as applied, clearly demonstrate that property-casualty insurers do not present a systemic risk to the U.S. financial system.

RESPONSES TO QUESTIONS FROM THE 7/28/11 HEARING

Questions from Representative Dold:

Question 1: Congress recognized and referenced the Quarterly Listing of Alien Insurers maintained by the NAIC in the NRRA Section 524, but it did not envision that the insurance brokers would be forced to purchase a list of alien insurers. Has there been any discussion or study as to this barrier's effect on the industry? If so, what are the results? If not, why has such discussion and study not taken place? What plans, if any, does the NAIC have to eliminate the current fees that are imposed to access the document (a total of $1000.00 per broker per year) and when will those changes be implemented?

Answer: The *Quarterly Listing of Alien Insurers* is a publication of the NAIC for which the NAIC charges $250 for domestic shipments and $275 for international shipments. The NAIC recognizes that Section 524 of the Nonadmitted and Reinsurance Reform Act effectively makes inclusion on the *Quarterly Listing* the national eligibility standard for alien insurers seeking to do nonadmitted insurance business within the United States. In recognition of NRRA's reference to the *Quarterly Listing*, the NAIC has made a version of the *Listing* with the names and alien identification numbers of listed insurers available free of charge through the NAIC website. Other information concerning listed insurers will be available through purchase of the *Quarterly Listing*.

Question 2: NIMA states have provided conflicting guidance to brokers and insureds about how to collect and distribute premium taxes in the period between July 21, 2011 and the NIMA clearinghouse's launch date (TBD). What plans, if any, to provide consistent guidance to the private sector?

Answer: In order to provide consistent guidance to the private sector, the NAIC's Surplus Lines Implementation (EX) Task Force adopted a model bulletin on nonadmitted insurance regulatory reform. The model bulletin is attached for your convenience. The Task Force intended the model bulletin to provide a template that could be utilized regardless of whether or not a state elected to participate in a multistate nonadmitted insurance premium tax allocation system. In fact, most states have issued bulletins on nonadmitted insurance regulatory reform and many have utilized the model bulletin as the basis for doing so.

Question 3: What was the federal policy toward rate regulation established by the McCarran-Ferguson Act? Did Congress view rate regulation as a method for ensuring price adequacy to protect solvency or was it intended to suppress rates to promote affordability and availability. If it was to ensure price adequacy to protect solvency, shouldn't Congress have an interest in state-based regulator efforts since rate suppression for affordability and availability undermines Congress' policy choices in McCarran?

Answer: I would not want to speculate to Congress on what was or was not Congress's intent in passing the McCarran-Ferguson Act. With that said, my understanding based on a review of law journal articles' analysis of the legislative history is that the intent of Congress in passing McCarran-Ferguson was to preserve the states' regulatory and taxing authority over insurance, which had been called into question by the Supreme Court's decision in *United States vs. South-Eastern Underwriter's Association.* The Southeastern Underwriter's case overturned a long-held belief by the courts that insurance was not a form of interstate commerce. The decision had nothing to do with rate regulation, but rather whether the Supreme Court decision (*Paul v. Virginia*) holding that insurance was not interstate commerce, should stand. In that context, the McCarran-Ferguson Act's purpose was not related to rate regulation specifically, though that certainly was implicated, but rather was recognition of the continued need for and the success of the state-based insurance regulatory regime, which, at that time, had been in place for over 75 years. Thus, the entire financial and market regulatory framework of the states was preserved, with one element of it being the regulation of the sale, policy provisions and pricing of insurance products.

We fully agree that Congress should have an interest in understanding insurance and all facets of insurance regulation. We would hope that Congress would have an interest in being briefed on a number of insurance and insurance regulatory issues not just rate regulation and we welcome the opportunity to provide such information whenever Congress desires it.

Question from Representative Royce:

Question 1: There appears to be broad support for the tax allocation system proposed by the Kentucky Department of Insurance. This seems to be one approach upon which both NIMA and SLIMPACT may be able to agree; what is your plan to achieve uniformity around the Kentucky proposal? Is this common allocation methodology being considered by those states that wish to allocate and share taxes on a multistate placement? If so, what steps are required to bring this to fruition, and what is the time frame?

Answer: NIMA included an allocation methodology when it as adopted by the Surplus Lines Implementation Task Force, NAIC Executive Committee and NAIC Plenary in December 2010. The NAIC is aware of recent discussions about the utilization of an alternative allocation methodology developed by the Kentucky Department of Insurance (KDI). This alternative allocation methodology is based upon the NIMA allocation methodology. The NAIC is aware that the KDI proposal is supported by many segments of the surplus lines insurance industry as well as those states that are participating in discussions to establish the Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT). The NAIC is further aware of discussions to incorporate the KDI proposal into NIMA, but is not aware that the Participating States to NIMA have made any decisions to do so. The NAIC would expect that any decisions concerning incorporation of the KDI proposal into NIMA would need to be made by the Participating States to NIMA in the near future.

Questions from Representative Stivers:

Question 1: Has a Non-admitted Insurance Multistate Agreement (NIMA) governing structure been established and a vendor been selected for the NIMA clearinghouse? What is the expected timeline for the clearinghouse and when is it expected to go live?

Answer: The NAIC understands that the Participating States to NIMA have established a governing structure and adopted amendments to NIMA that would authorize the establishment of a formal association. The NAIC further understands that the Participating States to NAIC have elected officers as follows: Commissioner Mike Cheney (Mississippi), President; Director Merle Scheiber (South Dakota), Vice President; Commissioner Kevin McCarty (Florida), Secretary. The NAIC understands that the Participating States to NIMA selected the Florida Surplus Lines Service Office as the clearinghouse vendor. The NAIC is aware that the Participating States to NIMA are working with the clearinghouse vendor to achieve operational status in the short term.

Question 2: Have the participating NIMA states approved their allocation methodology for multistate placements?

Answer: NIMA included an allocation methodology when it as adopted by the Surplus Lines Implementation Task Force, NAIC Executive Committee and NAIC Plenary in December 2010. The NAIC is aware of recent discussions about the utilization of an alternative allocation methodology developed by the Kentucky Department of Insurance (KDI). This alternative allocation methodology is based upon the NIMA allocation methodology. The NAIC is aware that the KDI proposal is supported by many segments of the surplus lines insurance industry as well as those states that are participating in discussions to establish the Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT). The NAIC is further aware of discussions to incorporate the KDI proposal into NIMA, but is not aware that the Participating States to NIMA have made any decisions to do so.

Question 3: Have the participating NIMA states been meeting to discuss implementation issues? If so, are these meetings open to the public? Are minutes of past meetings available to Congress and other interested parties? Has public input been solicited by the NIMA states on the major issues confronting the group?

Answer: The NAIC understands that the Participating States to NIMA have been meeting to discuss implementation issues, and the NAIC further understands that several recent conference calls and meetings of the Participating States to NIMA have been open to the public. The NAIC is not aware of the availability of minutes of past meetings, but the NAIC is aware that the Florida Office of Insurance Regulation is hosting a Web page with NIMA-related information at the following address: http://www.floir.com/Sections/PandC/NIMA.aspx.

Questions from Representative Garrett

Question 1: At the hearing, both organizations agreed to work together and cooperatively on harmonizing respective responses to the NRRA, especially with regard to the collection, allocation, and distribution of premium taxes paid in connection with multistate placements. What tangible steps have you taken in this regard since the hearing? Specifically, what are you doing to conform with the stated Congressional intent for the NRRA of uniformity in "requirements, forms, and procedures" through a compact, including the uniformity intended for "the reporting, payment, collection, and allocation of premium taxes" for single-state and multi-state nonadmitted business?

Answer: The NAIC anticipated that our Summer National Meeting would have provided the opportunity for several direct interactions between representatives of the participating states to NIMA and SLIMPACT as well as officials from the NAIC and NCOIL. Unfortunately, Hurricane Irene necessitated the cancellation of this meeting. The NAIC understands that the Participating States to NIMA conducted a conference call in place of the meeting that would have been held during the NAIC Summer National Meeting. Further, surplus lines issues were discussed during various meetings held in conjunction with the recently-concluded NAIC Fall National meeting, including a meeting conducted by the Participating States to NIMA.

The NAIC believes that NIMA provides an appropriate template for meeting Congress's intent for uniformity in requirements, forms and procedures, including uniformity relating to premium taxes for nonadmitted business. In fact, the NAIC supported efforts of states to enact enabling legislation to participate in a multistate allocation arrangement as well as amendatory legislation to otherwise conform state surplus lines statutes to the requirements of the NRRA. The NAIC believes that NIMA meets Congress's objectives because it provides for uniform allocation formulas and reporting methods. Because NIMA does not require the infrastructure of an interstate compact commission, it also allows states to move forward as quickly as possible in implementing a multistate nonadmitted insurance premium tax allocation solution. The NAIC is supportive of efforts to attempt harmonization of allocation methods under consideration by the Participating States to NIMA and states seeking to establish SLIMPACT, but any decisions concerning harmonization will require the agreement of those states.

Question 2: We appreciate that there will be no new taxes created by NIMA but we continue to hear that there will possibly be fees that will be imposed on insured as well as significant operating costs incurred by brokers. Please detail the amount and basis of calculation for any new fees imposed on brokers and/or insureds who make payments to the NIMA clearinghouse. Under what authority are they to be levied, to whom they will be paid and how they be utilized? Will these fees be in addition to or in lieu of fees currently paid to state stamping offices? Is it possible that the fees will provide a licensing royalty or profit to the clearinghouse and/or any other party?

Answer: Paragraph 15 of NIMA allows for the clearinghouse to collect a reasonable fee on transactions processed through the clearinghouse "to cover the cost of the operations and activities of the Clearinghouse." This fee is to be established by agreement between the Participating States to NIMA and the clearinghouse. If a Participating State has a stamping office, the stamping office may continue to receive any fees but NIMA does not require a state to collect a stamping office fee if it does not presently do so. The NAIC believes that any clearinghouse fees would be authorized through appropriate methods related to each Participating State to NIMA and that such fees would be levied as a transaction processing fee. Per NIMA's terms, the fee is intended as a cost-covering device. With the selection of the Florida Surplus Lines Service Office (FSLSO) as the clearinghouse, the NAIC anticipates the Participating States to NIMA and FSLSO will establish an appropriate fee consistent with NIMA's terms. Such decisions, however, will require the agreement of those parties.

Approved by Surplus Lines Implementation (EX) Task Force

NONADMITTED INSURANCE REFORM
SAMPLE BULLETIN

TO: All insurers eligible to write nonadmitted insurance in [State], all licensed surplus lines brokers, [all insureds independently procuring nonadmitted insurance and stamping office]

FROM: [Commissioner, Director, Superintendent]

DATE: [Insert Date]

RE: Implementation of federal Nonadmitted and Reinsurance Reform Act in [State]

The purpose of this bulletin is to outline nationwide regulatory changes that will affect the placement of nonadmitted insurance in [State]. The Nonadmitted and Reinsurance Reform Act of 2010 ("NRRA"), 15 U.S.C. § 8201 *et seq.*, provides that only an insured's "Home State" may require the payment of premium tax for nonadmitted insurance. Moreover, the NRRA subjects the placement of nonadmitted insurance solely to the statutory and regulatory requirements of the insured's Home State, and provides that only the insured's Home State may require a surplus lines broker to be licensed to sell, solicit or negotiate nonadmitted insurance with respect to such insured. 15 U.S.C. § 8202(a), (b). "Nonadmitted insurance," as defined in 15 U.S.C. § 8206(9), applies only to property and casualty insurance (excluding workers' compensation).

The NRRA becomes effective on July 21, 2011. For nonadmitted insurance business placed on or after July 21, 2011, the following information is provided for the benefit of insurers, brokers, [insureds and stamping offices]:

What is the scope of the NRRA?

The NRRA states that "the placement of nonadmitted insurance is subject to the statutory and regulatory requirements solely of the insured's home state" and that the NRRA "may not be construed to preempt any State law, rule, or regulation that restricts the placement of workers' compensation insurance or excess insurance for self-funded workers' compensation plans with a nonadmitted insurer." 15 U.S.C. § 8202. The NRRA does not expand the scope of the kinds of insurance that an insurer may write in the nonadmitted insurance market and each state continues to determine which kinds of insurance an insurer may write in that state. Although the NRRA preempts certain state laws with respect to nonadmitted insurance, it does not have any impact on insurance offered by insurers licensed or authorized in this state.

What is the insured's Home State for purposes of a particular placement?

[State] is the insured's Home State if the insured maintains its principal place of business here or, in the case of an individual, the individual's principal residence is here. If [State] is considered the insured's Home State, only [State's] requirements regarding the placement of such business will apply. If 100% of the insured risk is located outside of [State], then the insured's Home State is the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.

[If the state wishes to provide additional guidance on the interpretation of "principal residence" or "principal place of business," the state may consider inserting definitions of these terms consistent with the Nonadmitted Insurance Multi-State Agreement.]

If more than one insured from an affiliate group are named insureds on a single nonadmitted insurance placement, [State] will be considered the Home State for that placement if [State] is the Home State of the member of the affiliated group that has the largest percentage of premium attributed to it under such insurance contract.

How will these rules be applied?

New and renewal policies with an effective date prior to July 21, 2011 will be subject to the laws and regulations of [State] and other jurisdictions, as applicable, as of the policy effective date. The laws and regulations of [State] and other jurisdictions, as applicable, as of the effective date of such a policy will also apply to any modification to that policy during the policy period, such as all endorsements (including risk- and premium-bearing endorsements), installment payments and premium audits. New and renewal policies with an effective date on or after July 21, 2011, and any modifications thereto, will be subject only to the laws and regulations of [State] if [State] is the Home State of the insured.

What are the requirements for premium tax allocation and payment in this [State]?

As of July 21, 2011, the NRRA permits only the insured's Home State to require the payment of premium tax for nonadmitted insurance. Until July 21, 2011, the laws and regulations of [State] and other jurisdictions, as applicable, will continue to apply to premium tax due on multi-state placements.

It is the intent of the Department to issue additional bulletins if and when [State] begins participating in a tax sharing arrangement. Until additional bulletins are issued, the [State] tax rate should be applied to new and renewal policies with an effective date on or after July 21, 2011, when [State] is the insured's Home State. [Note: If the state intends to apply an alternate formula for computing the premium tax on multistate policies for which it is the Home State, that information should be inserted here.]

What are the license requirements for brokers?

Only the insured's Home State may require a surplus lines broker to be licensed to sell, solicit or negotiate nonadmitted insurance with respect to a particular placement. If [State] is the insured's Home State, the surplus lines broker must be licensed in [State]. The NRRA provides that [State] may not collect licensing fees for surplus lines brokers as of July 21, 2012, unless [State] participates in the NAIC's national insurance producer database or any other equivalent uniform national database. 15 U.S.C. § 8203. [State] participates in the National Insurance Producer Registry (NIPR), which provides such a database. [Note: If the state does not participate in NIPR, the state should describe its broker licensing requirements.]

When are the requirements for a diligent search and when is a diligent search not required?

[Insert general diligent search requirements for state].

On or after July 21, 2011, a surplus lines broker seeking to procure or place nonadmitted insurance on behalf of an "exempt commercial purchaser" is not required to perform a diligent search if: 1) the broker has disclosed to the exempt commercial purchaser that insurance may or may not be available from the admitted market that may provide greater protection with more regulatory oversight; and 2) the exempt commercial purchaser has subsequently requested in writing for the broker to procure or place such insurance from a nonadmitted insurer. "Exempt commercial purchaser" is defined in [insert State statute consistent with NRRA definition].

Approved by Surplus Lines Implementation (EX) Task Force

What are the eligibility requirements for nonadmitted insurers?

The NRRA restricts the eligibility requirements a state may impose on nonadmitted insurers. *See* 15 U.S.C. § 8204. For nonadmitted insurers domiciled in a U.S. jurisdiction, a broker is permitted to place nonadmitted insurance with such insurers provided they are authorized to write such business in their state of domicile and maintain minimum capital and surplus of $15 million [or the minimum capital and surplus amount required in State, whichever is greater]. [Note: If the state maintains a list of eligible insurers, the state may indicate where such information is available and/or how an insurer can be added to such a list.]

For nonadmitted insurers domiciled outside the U.S., a broker may place business with such insurers provided the insurer is listed on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC.

What are the key definitions from the NRRA?

The NRRA includes several definitions relevant to [State's] implementation of its requirements. Key definitions include the following:

- "**Exempt commercial purchaser**": The term ''exempt commercial purchaser'' means any person purchasing commercial insurance that, at the time of placement, meets the following requirements:

(A) The person employs or retains a qualified risk manager to negotiate insurance coverage.

(B) The person has paid aggregate nationwide commercial property and casualty insurance premiums in excess of $100,000 in the immediately preceding 12 months.

(C) (i) The person meets at least 1 of the following criteria:

(I) The person possesses a net worth in excess of $20,000,000, as such amount is adjusted pursuant to clause (ii).

(II) The person generates annual revenues in excess of $50,000,000, as such amount is adjusted pursuant to clause (ii).

(III) The person employs more than 500 full-time or full-time equivalent employees per individual insured or is a member of an affiliated group employing more than 1,000 employees in the aggregate.

(IV) The person is a not-for-profit organization or public entity generating annual budgeted expenditures of at least $30,000,000, as such amount is adjusted pursuant to clause (ii).

(V) The person is a municipality with a population in excess of 50,000 persons.

(ii) Effective on the fifth January 1 occurring after the date of the enactment of this subtitle and each fifth January 1 occurring thereafter, the amounts in subclauses (I), (II), and (IV) of clause (i) shall be adjusted to reflect the percentage change for such 5-year period in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor. 15 U.S.C. § 8206(5).

- "**Home State**":

(A) In General.—Except as provided in subparagraph (B), the term ''home State'' means, with respect to an insured—

(i) the State in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence; or

(ii) if 100 percent of the insured risk is located out of the State referred to in clause (i), the State to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.

(B) Affiliated Groups.—If more than 1 insured from an affiliated group are named insureds on a single nonadmitted insurance contract, the term ''home State'' means the home State, as determined pursuant to subparagraph (A), of the member of the affiliated group that has the largest percentage of premium attributed to it under such insurance contract. 15 U.S.C. § 8206(6).

- "**Independently procured insurance**": The term''independently procured insurance'' means insurance procured directly by an insured from a nonadmitted insurer. 15 U.S.C. § 8206(7).

- "**Nonadmitted insurance**": The term ''nonadmitted insurance'' means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance. 15 U.S.C. § 8206(9).

- "**Nonadmitted insurer**": The term ''nonadmitted insurer''—

    (A) means, with respect to a State, an insurer not licensed to engage in the business of insurance in such State; but

    (B) does not include a risk retention group, as that term is defined in section 2(a)(4) of the Liability Risk Retention Act of 1986 (15 U.S.C. 3901(a)(4)). 15 U.S.C. § 8206(11).

- "**Premium tax**": The term ''premium tax'' means, with respect to surplus lines or independently procured insurance coverage, any tax, fee, assessment, or other charge imposed by a government entity directly or indirectly based on any payment made as consideration for an insurance contract for such insurance, including premium deposits, assessments, registration fees, and any other compensation given in consideration for a contract of insurance. 15 U.S.C. § 8206(12).

- "**Qualified risk manager**": The term ''qualified risk manager'' means, with respect to a policyholder of commercial insurance, a person who meets all of the following requirements:

    (A) The person is an employee of, or third-party consultant retained by, the commercial policyholder.

    (B) The person provides skilled services in loss prevention, loss reduction, or risk and insurance coverage analysis, and purchase of insurance.

    (C) The person—

        (i) (I) has a bachelor's degree or higher from an accredited college or university in risk management, business administration, finance, economics, or any other field determined by a State insurance commissioner or other State regulatory official or entity to demonstrate minimum competence in risk management; and

            (II) (aa) has 3 years of experience in risk financing, claims administration, loss prevention, risk and insurance analysis, or purchasing commercial lines of insurance; or

                (bb) has—

                    (AA) a designation as a Chartered Property and Casualty Underwriter (in this subparagraph referred to as ''CPCU'') issued by the American Institute for CPCU/Insurance Institute of America;

                    (BB) a designation as an Associate in Risk Management (ARM) issued by the American Institute for CPCU/Insurance Institute of America;

                    (CC) a designation as Certified Risk Manager (CRM) issued by the National Alliance for Insurance Education & Research;

                    (DD) a designation as a RIMS Fellow (RF) issued by the Global Risk Management Institute; or

                    (EE) any other designation, certification, or license determined by a State insurance commissioner or other State insurance regulatory official or entity to demonstrate minimum competency in risk management;

        (ii) (I) has at least 7 years of experience in risk financing, claims administration, loss prevention, risk and insurance coverage analysis, or purchasing commercial lines of insurance; and

            (II) has any 1 of the designations specified in subitems (AA) through (EE) of clause (i)(II)(bb);

(iii) has at least 10 years of experience in risk financing, claims administration, loss prevention, risk and insurance coverage analysis, or purchasing commercial lines of insurance; or
(iv) has a graduate degree from an accredited college or university in risk management, business administration, finance, economics, or any other field determined by a State insurance commissioner or other State regulatory official or entity to demonstrate minimum competence in risk management. 15 U.S.C. § 8206(13).

- "**Surplus lines broker**": The term ''surplus lines broker'' means an individual, firm, or corporation which is licensed in a State to sell, solicit, or negotiate insurance on properties, risks, or exposures located or to be performed in a State with nonadmitted insurers. 15 U.S.C. § 8206(15).

- "**State**": The term ''State'' includes any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa. 15 U.S.C. § 8206(16).

NCOIL

National Conference of Insurance Legislators

...for the states

September 9, 2011

Representative Robert J. Dold
U.S. House Committee on Financial Services
Subcommittee on Insurance, Housing & Community Opportunity
2113 Rayburn House Office Building
Washington, DC 20515

Dear Representative Dold:

Thank you for your follow-up question to the July 28 House Committee on Financial Services Subcommittee on Insurance, Housing & Community Opportunity hearing, entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs," regarding a 2011 Property and Casualty Insurance Report released by the Heartland Institute.

Since NCOIL has not formally reviewed the new Heartland report and does not have a position on its methodology and/or conclusions, I will respond to your query in a general manner.

NCOIL believes that the U.S. state-regulated insurance marketplace—the largest in the world—has successfully weathered the financial crisis and subsequent economic downturn due in large part to the knowledge and expertise provided by state legislators and regulators on the ground in the states.

NCOIL supports legislators' authority and flexibility to regulate their unique state markets based on their experienced determinations of the most appropriate policy solutions for their respective states. Coming together at forums like NCOIL, NCSL, and NAIC, lawmakers and regulators—representing our "laboratories of democracy"—work together to make the tough decisions on public policy and to strike a balance in protecting our consumers and fostering a healthy and thriving insurance marketplace.

Regarding rate regulation, NCOIL—serving in its role as an educational resource to state lawmakers—has adopted two model acts for legislatures to consider if/when appropriate. An NCOIL *Property/Casualty Insurance Modernization Act* creates a competitive, use-and-file regulatory system for personal lines of insurance, a no-file system for commercial lines, and would allow regulatory exemptions for policies sold to large, sophisticated commercial insurance buyers. An NCOIL *Property/Casualty Flex-Rating Regulatory Improvement Model Act*—an interim step toward creating a more open rate-filing and review system—calls for a 12 percent flex-band, based on statewide aggregate increases or decreases, within which an insurer can expeditiously file rate changes during any 12-month period.

NCOIL looks forward to working with you and your Committee colleagues as insurance issues emerge in this 112th Congress.

Best regards,

Greg Wren

Rep. Greg Wren (AL)
NCOIL Treasurer

cc: NCOIL Legislators

NCOIL/2011/2007459

Labor Department Should Rethink Investment Advice Proposal

Dirk Kempthorne, ACLI President & CEO

Half of America's pre-retirees—workers between the ages of 50 and 65—have less than $63,000 in financial assets. For many of these workers, that is far below the amount they'll need for a retirement that could last 20 years or more.

Americans need help with the important decisions associated with retirement planning. Advice and education are crucial to long-term financial security. As an industry deeply involved in helping Americans prepare for retirement, life insurers are keenly aware that good financial advice means a better retirement. The Department of Labor's (DOL) initiative threatens the availability and affordability of this advice for those who need it most—middle-income workers and their families.

DOL plans to overhaul 35 years of established rules governing who can provide investment advice, education and information to retirement plan participants and IRA account holders. DOL's untested proposal would shake the foundation of a system that is working well at the very time Americans need it most.

The proposal threatens to undermine long-standing and well-understood relationships between investment professionals and their clients and it would come at a high cost. The firm Oliver Wyman estimates that DOL's proposal could increase the cost of investment advice anywhere from 75 to 195 percent. With the economy struggling and with too many Americans ill prepared for long retirements, reducing access to competent financial advice represents unsound public policy.

Data from the Employee Benefit Research Institute tells an important story: workers are more pessimistic today about their chances for a comfortable retirement than at any time over the past 20 years. Some 42 percent responding to an EBRI survey said they determine their retirement savings needs by "guessing."

Guessing is not a retirement strategy. Given the diversity of retirement savings and planning options, workers will need advice on how to manage their assets to last a lifetime. A large, bipartisan group of Senate and House members agree.

These members want to know the proposed rule's impact on working families' ability to save for retirement. They also want to know whether the proposal would result in high costs that would make many financial products—including innovative products designed to address increasing longevity—inaccessible to the families that need the most help. In addition, they are asking whether a new rule would conflict with or duplicate other regulations.

Life insurers and their financial advisers agree these questions must be answered. Without fully analyzing the current marketplace and its regulations, DOL has no basis for determining whether its proposal will actually improve on existing consumer protections, or whether its costs will outweigh the benefits.

Given the importance of financial advice, it is crucial DOL gets it right. The best way to develop final, workable rules would be through a vibrant, public/private-sector dialogue. A new proposal, reflecting a thorough economic analysis of the pros and cons of revamping the current system, would well serve America's working families, the ones who need access to competent financial advice.

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NCOIL

National Conference of Insurance Legislators

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August 24, 2011

Representative Scott Garrett
U.S. House Committee on Financial Services
Subcommittee on Insurance, Housing & Community Opportunity
2113 Rayburn House Office Building
Washington, DC 20515

Dear Representative Garrett, Chairperson Biggert, and Subcommittee Members:

Thank you for your follow-up question to the Subcommittee hearing, entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs" on July 28, relating to what steps NCOIL has taken to work with the NAIC on surplus lines tax allocation and regulation and what NCOIL is doing to promote uniformity in response to Dodd-Frank.

As NCOIL President Rep. George Keiser (ND) responded in a July 29 letter to the initial question posed by Chairperson Biggert at the hearing, NCOIL has recommitted its efforts to find a unified response to surplus lines reform *(attached)*.

NCOIL sent a letter on the same day to the NAIC asking regulators to consider joining SLIMPACT in order to achieve synergy and streamline the surplus lines regulatory system *(also attached)*. NCOIL leaders will again reach out to insurance regulators at the NAIC summer meeting in Philadelphia next week on August 28 through September 1.

Regarding efforts to promote uniformity, SLIMPACT representatives in an August 18 meeting supported—in a straw vote—an allocation process brought forward by the Kentucky Department of Insurance that responds to the NRRA in its simplicity and use of readily available data.

The Kentucky formula is supported by many industry organizations and advocates of Dodd-Frank surplus lines provisions, including but not limited to the American Association of Managing General Agents (AAMGA), American Bankers Insurance Association (ABIA), American Insurance Association (AIA), California Insurance Wholesalers Association (CIWA), Council of Insurance Agents & Brokers (CIAB), Independent Insurance Agents & Brokers of America (IIABA), National Association of Mutual Insurance Companies (NAMIC), National Association of Professional Surplus Lines Offices (NAPSLO), Property Casualty Insurers Association of America (PCI), and The Risk and Insurance Management Society (RIMS).

NCOIL has indications the Kentucky formula is capable of gaining support with non-SLIMPACT state insurance department representatives.

NCOIL continues to support and promote accountability, transparency, and uniformity provided by the SLIMPACT governance structure and its authority to require uniform notice and foreign eligibility provisions. We believe SLIMPACT fully responds to the NRRA stated intent of "nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provides for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance"—something that no other proposal in play offers.

Best regards,

Greg Wren

Rep. Greg Wren (AL)
NCOIL Treasurer

NCOIL/2011/2007449c

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NCOIL

National Conference of Insurance Legislators

...for the states

August 31, 2011

Representative Ed Royce
U.S. House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Representative Royce and Committee Members:

This letter will respond to your inquiry regarding a proposed Kentucky tax allocation formula informally supported by representatives of the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT), as a follow-up question to the July 28 House Committee on Financial Services Subcommittee on Insurance, Housing & Community Opportunity hearing, entitled "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs".

NCOIL applauds Kentucky Insurance Commissioner Sharon Clark and her Department for working within Congress's dictates through an interstate compact that answers all requirements of the NRRA, not just the minimum of tax allocation criteria—as does the Nonadmitted Insurance Multistate Agreement (NIMA). The Kentucky formula—simplistic and using readily available data—has garnered not only SLIMPACT favor, but that of many industry and producer organizations and NRRA advocates. It has been indicated that the Kentucky formula is capable of gaining support with non-SLIMPACT state insurance department representatives, as well.

NCOIL would like the National Association of Insurance Commissioners (NAIC) to consider not only the proposed Kentucky allocation formula, but also the total SLIMPACT approach. NCOIL legislators stand in support of SLIMPACT because it—and it alone—responds to the NRRA intent of simplicity and consistency. It is unique in its ability to provide uniform notice and eligibility requirements and in its balanced, accountable and transparent governing structure.

NCOIL has asked NAIC for input throughout SLIMPACT development and has recently asked NAIC regulators again to join with us in SLIMPACT, as we believe that individual Commissioners can impact SLIMPACT by facilitating their states joining the compact. NCOIL had planned to bring this up yet again with NAIC at its Philadelphia Summer Meeting, which was cancelled due to Hurricane Irene.

NCOIL realizes the advantages of finding a common ground, but not at the expense of the surplus lines industries and consumers in our states. SLIMPACT will keep surplus lines regulation truly in the states and not in a contract such as NIMA, which by its very nature could be subject to change at any given moment. SLIMPACT provides the safety, security, and uniformity that Congress and Dodd-Frank advocates are looking for and that legislators believe in.

Best regards,

Greg Wren

Rep. Greg Wren (AL)
NCOIL Treasurer

cc: NCOIL Legislators

NCOIL/2011/2007455a

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ACLI
Financial Security...for Life.

Gary E. Hughes
Executive Vice President & General Counsel

August 26, 2011

The Honorable Brad Sherman (D-CA)
U.S. House of Representatives
2242 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Sherman,

Thank you for your question during the July 28th hearing before the House Financial Services Insurance, Housing, and Community Opportunity Subcommittee, titled, "Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs." As the panel witness from the American Council of Life Insurers (ACLI), I've inquired further with our member companies to help accurately respond to your question addressing the availability of inflation adjusted "longevity insurance."

Many ACLI member companies offer lifetime income annuities, either Single Premium Immediate Annuities (SPIA's) or Deferred Income Annuities (DIA's). Most Single Premium Immediate Annuities, which can provide income for life starting within twelve months of the purchase, offer a cost-of-living adjustment (COLA) option, and some offer a consumer price index (CPI) inflation protected feature. A Deferred Income Annuity, sometimes called 'longevity insurance', provides income beginning at a later age, for example age 85, continuing for the lifetime of the annuitant. Some Deferred Income Annuities do offer inflation protection features, though they may not be available for purchase until the time payments commence, due to the difficulty in projecting the cost so far into the future.

Long term savings are just one way life insurers help protect the financial future of 75 million American families. Life insurance and annuities provide financial protection, peace of mind, and a guarantee of lifetime income when it's time to retire.

Thank you again for your question and I hope this background is helpful. Please let me know if you have any further questions about these products or if you would like to discuss this issue further.

Sincerely,

Gary E. Hughes

Gary E. Hughes

CC: Congresswoman Judy Biggert (R-IL)
Congressman Luis Gutierrez (D-IL)

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