



NATIONAL CONFERENCE *of* STATE LEGISLATURES

The Forum for America's Ideas

EXECUTIVE COMMITTEE TASK FORCE TO STREAMLINE
AND SIMPLIFY INSURANCE REGULATION

REPORT TO THE NCSL EXECUTIVE COMMITTEE

NCSL Annual Meeting
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Denver, Colorado

OVERVIEW

The NCSL Executive Committee charged the Task Force to explore the issues that confront state insurance regulation in the changing financial marketplace and, if necessary, to develop and review draft legislation for state consideration. The Task Force has three primary objectives.

- To preserve the primacy of state insurance regulation against congressional and industry initiatives to establish a federal insurance regulator and to preempt state insurance and consumer protection laws
- To consider reforms that would allow insurance companies to compete more effectively in the integrated financial marketplace and to respond with innovation and flexibility to evermore demanding market forces
- To maintain and improve strong consumer protections, which are the hallmark of the state regulatory system

Insurance serves as the cornerstone of the economy. It allows people to guard against unforeseen events and businesses to manage risk and to undertake ventures that they otherwise may not. In a corporate environment defined by Enron and WorldCom, where companies can disappear virtually overnight and take with them billions in retirement funds, insurance companies maintain reserves to pay claims if and when benefits are due, years into the future, even if the company goes bankrupt. And if the unthinkable occurs—as it did on Sept. 11, 2001—insurance provides the money to rebuild and cover economic loss.

Over a century of state insurance regulation has proven that states effectively protect consumers and ensure that promises made by insurers are kept. State regulators are accessible and accountable to the public and are sensitive to local economic and social conditions. State regulation places with state legislatures the responsibility to set policies that directly affect state markets and empowers lawmakers to step in, when needed, to assist constituents. Federal insurance regulation also threatens substantial state revenues that are collected from insurance taxes, fees and fines—nearly \$10.5 billion in 2000, of which 88 percent went to state general funds (see the attached fact sheet on state insurance revenues).

FEDERAL ACTION

Current federal interest in insurance regulation began with the Financial Modernization Act of 1999—also called Gramm-Leach-Bliley—which established a comprehensive framework to permit affiliations among banks, securities firms and insurance companies. Although states have met the federal mandates of the act, Congress—encouraged by industry—continues to pressure states to go further to streamline, simplify and coordinate state insurance regulation. The U.S. House of Representatives Financial Services Committee has held regular hearings on insurance regulatory reform—and promises more—and U.S. Senator Charles Schumer of New York has introduced legislation that would create an optional federal insurance regulator and would permit companies to bypass state insurance and consumer protection laws.

TASK FORCE ACTION

The Task Force has worked closely with state insurance regulators, who—through the National Association of Insurance Commissioners (NAIC)—already have responded with considerable vigor to federal and industry pressure for more effective and responsive insurance regulation. The NAIC's leadership participates in Task Force discussions and continues to keep legislators informed on their progress in the many areas of reform. The Task Force also has received invaluable input, assistance, research and advice from the National Conference of Insurance Legislators (NCOIL).

The Task Force's focus during its first year has been to engage broad policy issues and to explore possible legislative action. Work has centered on two major issues. The first is product regulation reform—often called “speed to market.” The second is market regulation reform.

Speed to Market Issues

The changing financial marketplace demands “speed to market” reforms to allow insurance companies to market products nationally within a reasonable time period to compete more effectively in the integrated financial marketplace. Different issues pertain to life insurance and property and casualty (P/C) insurance.

Life insurance. The Task Force is reviewing an NAIC proposal to establish an Interstate Insurance Compact to develop uniform national standards for annuity, life insurance, disability income and long-term care insurance products and to receive, review and give appropriate regulatory approval to product filings (see the attached compact summary). The integrated financial marketplace acutely affects life insurers, whose policies increasingly have evolved into long-term investment products that face direct competition from the products of banks and securities firms. The current 50-state product approval system requires greater time and expense for life insurers to market their products nationally when compared to their federally regulated competitors. This also is the principal reason that life insurers now pursue federal insurance regulation.

The NAIC believes that an interstate compact is the right mechanism to address legitimate industry concerns and to preserve and improve state consumer protections. It would allow states to jointly develop uniform product standards and more efficiently review and approve products to be sold nationally. It would continue the prior approval system that is appropriate for life insurance products, would retain state authority to protect consumers after a product is sold and would ensure consistent standards when holders of these long-term investment policies move across state lines.

The Task Force and the NAIC have reached consensus on certain components that are included in the current interstate compact draft, but several remain under review. These include (1) the composition of the management committee (see the attached summary and map of the two

management committee options), (2) the method to appoint legislative oversight committee members, and (3) the inclusion of long-term care products.

The Task Force will be discussing these issues in the months ahead and will consider a recommendation on the interstate compact to the NCSL Executive Committee for its meeting in Portland, Maine on October 4 and 5.

P/C insurance. The Task Force also has begun to review proposals to reform product regulation systems for P/C insurance. P/C insurance includes both personal lines—such as auto and home insurance—and commercial insurance bought by businesses.

Most states currently have what are called “prior approval” systems that require regulators to approve in advance the rates that insurers can charge and the forms—or the actual policy contracts—that they can sell. These systems were developed in the early twentieth century principally to protect against inadequate rates—a concern now addressed through uniformly adopted financial solvency regulations. Insurers, agent groups and most commissioners favor “market-based regulation”—or reforms that emphasize the use of competitive markets to regulate products. However, insurers, agent groups and commissioners disagree on many aspects of market-based reforms, especially rate regulation, and consumer groups continue to support prior approval systems.

The Task Force has examined two proposals to address P/C “speed to market” issues. An NAIC commercial lines model law would rely on a presumption that rates are not excessive in a competitive market and would require regulators to review and approve forms within 30 days. The commissioner would be required to evaluate competition each year and would retain the authority to act if a product was shown to be out of line or unfair. Rates would be filed with the commissioner and could be denied if not actuarially sound. The NAIC model does not address personal lines.

A competing model by the NCOIL would rely on a presumption that rates are not excessive in a competitive market for commercial and personal lines. Insurers would not need to file commercial rates and personal rates would have to be filed within 30 days of their use by companies. The commission would retain the authority to disapprove rates that are inadequate or unfair or that are excessive following a ruling that the market is noncompetitive. The NCOIL model does not address form regulation.

Market Regulation Reform

Market regulation reform represents a key component of “market-based” systems—as states shift regulatory emphasis from product approval to greater oversight of how companies conduct themselves in the market. The Task Force has begun to examine the significant reform efforts already launched by state regulators to enhance market analysis functions, to improve market conduct exams and to increase interstate cooperation. This effort has been guided by a 2000 NCOIL market conduct study that found duplication of exams, under-trained examiners and no dedicated market conduct units in some states.

The Task Force continues to explore possible legislative action to help regulators monitor market competition and company practices; to promote more efficient, effective and uniform market conduct exams; and to coordinate market conduct activities in an effort to reduce redundancies and stretch resources. The NCOIL also is engaged in a second and final market conduct study.