



NATIONAL CONFERENCE of STATE LEGISLATURES

The Forum for America's Ideas

EXECUTIVE COMMITTEE TASK FORCE TO STREAMLINE AND SIMPLIFY INSURANCE REGULATION

JULY 10, 2002
SHERATON BOSTON HOTEL
BOSTON, MASSACHUSETTS

PRELIMINARY MEETING SUMMARY*

Task Force Members

Senator Hannon (NY), Co-chair
Representative Counts (TX), Co-Chair
Assemblywoman Farragher (NJ)
Representative Keenan (VT)
Senator Larkin (NY)
Representative Mautino (IL)
Representative Waters (FL)

Staff

Andrew Beal, NAIC
Cheye Calvo, NCSL
Steve Casscles, Senator Larkin
Candace Frick, NCOIL
Robert Mackin, NCOIL
Susan Nolan, NCOIL
Jenn O'Connor, NCOIL

Commissioners

Commissioner Vaughan (IA), NAIC President
Director Covington (OH)
Commissioner Fitzgerald (MI)
Commissioner Gallagher (FL)
Commissioner Koken (PA)
Commissioner Montemayor (TX)
Commissioner Pickens (AR)
Commissioner Poolman (ND)
Administrator Shapo (IL)

OPENING AND INTRODUCTIONS

Senator Hannon opened the meeting on Wednesday, July 7, 2002 at 12:27 p.m. Introductions were made. Senator Hannon reviewed the agenda and called on Representative Counts to provide the congressional activity update.

* The preliminary meeting summary provides a general review of comments made and sentiments expressed by meeting participants, but does not give a comprehensive restatement of every remark. Therefore, this document is a meeting summary, not meeting minutes.

CONGRESSIONAL ACTIVITY UPDATE

Representative Counts said that Congress has been active this summer with regards to insurance regulation, specifically with the Senate joining the House of Representatives in passing legislation to offer a federal backstop for terrorism insurance coverage. More related to the purpose of the Task Force, he said, the U.S. House Committee on Financial Services in June held a three-part series of hearings on the future of insurance regulation.

Representative Counts said that the three days of hearings reviewed the many components and functions of insurance regulation and framed the issues for future work by the U.S. House of Representatives. The three days of testimony included Representative Mark Young of Vermont, who testified on behalf of NCOIL, and Iowa Insurance Commissioner and NAIC President Terri Vaughan, who testified on the value of state regulation to consumers and provided Congress with an update on state reforms, he said. Representative Counts added that it was often industry representatives that supplied the strongest support of state regulation, in particular was Wayne White of Home Mutual Insurance representing NAMIC. He added that other groups, like IIABA, also expressed strong continued support for the state system but encouraged federal involvement to preempt some state laws and mandate other reforms in a fashion similar to the NARAB provision of Gramm-Leach-Bliley.

Representative Counts said that Financial Services Committee Chairman Michael Oxley opened the third hearing with a promise for future work in the months ahead. Representative Counts said Chairman Oxley noted the success of state efforts on producer licensing but called for more work in the area to achieve reciprocity in every state and the ultimate goal of uniformity. Representative Counts said that Chairman Oxley called the NAIC's experiment with CARFRA a misstep, said that consumers cannot afford for the interstate compact to be another and concluded by saying he hoped that the alliance between the NAIC and state legislators would bring reform.

NAIC PRESENTATION ON INTERSTATE INSURANCE COMPACT

Commissioner Vaughan reviewed the changes to the interstate insurance compact discussion draft from the previous version. These include the following items:

- Revised language to specifically include "individual and group" life insurance products
- Revised "Purposes" and "Powers" provisions to clarify that the commission will have the power to review product filings in a prompt manner
- Amended language to clarify that a "member" does not have to be an employee of a state insurance department
- Clarified language to provide that judicial proceedings will be brought "in an appropriate Court where the principal office of the Commission is located"
- Added language to clarify that the commission only may promulgate "reasonable" rules, including uniform standards and operating procedures to achieve the purposes of the compact
- Added language to clarify that a self-certification process may be provided for use of products "without the need for prior approval of the Commission"
- Added language to include "rate filing" for long-term care insurance products

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- Added language to clarify that the commission has the power to establish or appoint advisory committees
- Added language in the drafting note to describe four options for composition of the management committee and noted that consideration of a super-majority vote by the management committee for decisions related to the development of uniform standards
- Amended language to clarify that officers of the commission would be elected by the commission from among members of the commission
- Added language to provide for the creation of an advisory committee, the members of which would be appointed by NCSL and NCOIL to monitor the operations of the commission and make non-binding recommendations
- Revised language to reflect that a state may “opt out” of a uniform standard for a specific product line either by legislation or regulation and revised language for the regulatory “opt out” to require a finding that the “Uniform Standard is not appropriate considering the prevailing conditions in that State”
- Moved language regarding product review standards and revised language to it make consistent with other language in the draft
- Left open the issue of whether review of commission decisions regarding product filings also applies to product approvals and revised language that provided for judicial review
- Added language to clarify that the commission may reconsider products subsequent to their initial approval and that approval may be withdrawn after notice and hearing
- Revised language to address treatment of products approved by the commission in a state that withdraws from the compact or is in default
- Revised language to clarify that products filed with the commission will be subject to the rules and operating procedures of the compact, which supersedes conflicting state law, while recognizing that individual states will be responsible for regulating market activities

Commissioner Vaughan said that there were seven issues where the NAIC has found consensus and five additional issues that remain outstanding. She said the first point of consensus is that there must be a single point of filing with uniform product standards. Second, she said, they agree the compact should include annuity, life insurance and disability income products. Third, she said, they agree that advisory committees must play a role. Fourth, she said, they agree that there should be an unrestricted legislative opt out and a regulatory opt out that requires a finding that the “Uniform Standard is not appropriate considering the prevailing conditions in that State.” Fifth, she said, they agree that there should be judicial review. Sixth, she said, they agree that insurance companies should have the option of filing directly in states. Finally, she said, they agree that states should perform market conduct regulation.

The first outstanding issue, said Commissioner Vaughan, is the composition of the management committee. Second, she said, commissioners have not resolved what level of detail should be included in the compact legislation and, if additional detail is appropriate, what that level of detail should be. Third, she said, they have not resolved whether to require a super-majority vote for the management committee to submit uniform standards to the commission. However, she noted that they were leaning in favor of it.

Fourth, said Commissioner Vaughan, commissioners have not resolved the selection of members of the commission. She said that commissioners discussed the model of the Streamlined Sales Tax Project, which uses three-person teams with two legislative appointments, but she said that commissioners discussed the development of standards, which primarily are regulatory in nature—although they also include statutory requirements. She then distributed copies of uniform product standards developed by CARFRA to underscore that the standards go into much greater detail than typically is given to such matters by legislatures. Fifth, she said, they had not concluded whether to include long-term care products in the compact.

TASK FORCE DISCUSSION

The major issue of discussion related to the composition of the management committee. Several Task Force members asked for clarification regarding the four options outlined in the draft. Senator Hannon asked commissioners to explain them one by one. The four options are outlined below.

Option 1: 12 total members—1 member from each of the six largest states, according to premium volume for life and annuity products, for a total of 6 large state members; 1 from each of 4 NAIC zones and 2 members elected at-large for an additional 6 members from smaller states

Option 2: 11 total members—1 member from each of the four largest states for a total of 4 large state members; 1 from each of 4 NAIC zones for an additional 4 members from smaller states; and 3 officers elected at-large

Option 3: 14 total members—1 member from each of the six largest states, or those with at least 4.5 percent of the nation's premium volume for life and annuity products, for a total of 6 large state members; 4 members from the 11 midsize states, or those with between 2 percent and 4.5 percent of premium volume, for a total of 4 midsize state members; and 1 member from the remaining states from each of 4 NAIC zones for an additional 4 smaller state members

Option 4: Sets a range of management committee members and directs the selection of members to be determined in the bylaws

Commissioner Vaughan said that Option 1, which was proposed by the large states, was included as a drafting note in the earlier draft. She said that commissioners from several states expressed concern that Option 1 gave the six largest states too much power in the management committee. She said Option 2 was proposed to address concern that the officers are not included automatically on the management committee in Option 1. Option 3 was drafted by Director Covington to put in place a three-tier system where midsize states would be represented separately from smaller states, said Commissioner Vaughan. She said that Option 4 postponed the decision to the bylaws, which actually follows the approach used by the Streamlined Sales Tax Project.

Commissioner Gallagher said that it was important for the large states to have a disproportionate say in the management committee in order to satisfy legislative concerns. He said that large states, especially the four largest states of California, Texas, New York and Florida, disproportionately contribute resources to the NAIC, and he expects that this also would be true for the compact.

Commissioner Montemayor said that Option 1 would make the compact more attractive to lawmakers in Texas.

Director Covington said that he drafted Option 3 to recognize the differences between the midsize states and smaller states. He said that midsize states are defined as states with between 2 percent and 4.5 percent of the nation's premium volume for life insurance and annuity products, which includes 11 states. These states represent 31 percent of premium volume, he said, compared to 40 percent for the six large states.

Commissioner Vaughan said that the commissioners wanted to resolve large state concerns and encourage these states to join the compact. Commissioner Poolman said that smaller states may not have a large portion of market share, but they, too, have legislatures that must make the case that the concerns of their state will be addressed by the compact.

Senator Hannon asked Task Force members which options they preferred. Representative Waters said that she preferred Option 1. Assemblywoman Farragher said that it was essential to obtain participation in the compact by large states and discussed representative apportionment. Representative Mautino said that he preferred Option 1. Senator Larkin said that Option 3 made more sense and would be acceptable to the majority of states.

Senator Hannon said that he appreciated the elegance of Option 3, but it seemed that many others supported Option 1.

Based on information provided by Director Covington, Senator Hannon clarified that Option 1 would give the six large states half the votes on the management committee compared to 40 percent of life insurance and annuity premium volume. Director Covington said that Option 3 would better approximate the three groups' respective shares of life and annuity premium volume. He said that the large states would get 42 percent of the members compared to 40 percent of premiums while the midsize and smaller states each would receive 29 percent of members for 31 percent and 29 percent of premiums, respectively.

PUBLIC HEARING ON INTERSTATE COMPACT

Bruce Ferguson with ACLI and Bill Fischer with Mass Mutual Life addressed the Task Force. Mr. Ferguson said that ACLI has spent much time discussing the compact as a concept, and it is their goal to get behind it and encourage its enactment in the states. Mr. Fischer, he said, would discuss ACLI's specific concerns.

Mr. Fischer said the ACLI working group met in late June to identify preliminary concerns with the June 4 draft. Although he said that they have not had the opportunity to thoroughly vet this draft, he identified several concerns. First, he said they are concerned about its political viability, which they see as a heavy political lift. Additionally, he said that they were pleased that the compact now refers to "prompt and efficient review" and that it explicitly allows self-certification for some products. He said that they would like to clarify that market regulation is not a responsibility of the compact. He said that the liberalization of the opt out process addresses concern that a higher threshold may prevent states from joining. They have questions regarding the management committee, he said. He asked about the specific reference to individual and group life insurance. He expressed concern

regarding the inclusion of prior approval for advertising. He said that he had questions about the standards of review and the exclusive jurisdiction clause. He noted that there were no standards for withdrawal of product approval. Finally, he said that product standards should preempt not just conflicting standards but also supplemental requirements.

Senator Hannon asked about advertising approval requirements in states. Mr. Fischer said that while there often are advertising requirements, they generally do not require prior approval with the exception of a few states. They do not mind the standards, said Fischer, but they oppose prior approval requirements.

Representative Mautino said that smaller states should support this because it will enable them to do more than they do now or to do it with greater efficiencies. Assemblywoman Farragher asked how many states have automatic approval of products after they are approved in a certain number of states. Mr. Ferguson said that that provision was unique to New Jersey.

Representative Mautino suggested that the Task Force vote to eliminate management committee Option 2 and Option 4, for which no one expressed support. Senator Hannon asked if there were any objections. There were none. Senator Hannon then asked that only Option 1 and Option 3 be included in future drafts.

Robert "Skip" Myers, who is a member of the law firm Morris, Manning & Martin, LLP but spoke as an individual, addressed the Task Force to raise two issues regarding judicial review and to ask how the compact may be affected by the extra territorial provision of New York law.

Senator Hannon called for a 15-minute break.

TASK FORCE DISCUSSION—PLANS FOR DENVER MEETING

Senator Hannon moved forward the Task Force discussion to future plans on the agenda. He said that the primary purpose of the Task Force meeting in Denver on July 23 is to finalize the Task Force's report to the NCSL Executive Committee and that the Task Force Co-Chairs will deliver the report to the Executive Committee on the afternoon of Tuesday, July 23.

Senator Hannon asked Commissioner Vaughan to discuss the NAIC's timeframe. Commissioner Vaughan said that the NAIC would like to approve the interstate insurance compact at its fall meeting in New Orleans from September 9 to 12. She said that commissioners were holding a two-day interim meeting in Chicago on August 14 and 15 to discuss the compact.

Senator Hannon said that the NCSL Executive Committee is scheduled to meet in early October in Portland, Maine. He raised the possibility of the Task Force meeting in New Orleans prior to the NAIC meeting and again following the NAIC adoption of the compact—possibly prior to the meeting in Portland—to consider whether to recommend the compact to the NCSL Executive Committee. The decision was deferred until the Task Force meeting in Denver.

REGULATORY ISSUES FOR PROPERTY AND CASUALTY LINES

Roger Schmelzer with NAMIC, JoAnne Kron with Allstate and Mark Skinner with AIA addressed the Task Force. Mr. Schmelzer spoke for the group to say that to look at speed to market only for life insurance is incomplete public policy.

Mr. Schmelzer said they he considered speed to market reform as a rebalancing of regulator resources—one that adds value for consumers. He said that the P/C trade groups are very interested in talking about how to rebalance. States should begin with market conduct reform, where the NAIC is going down the right track, he said, to stress coordination, uniformity and targeted exams. Mr. Schmelzer said that states should use the market to regulate products. They should start with the presumption of competitiveness, he said, but give regulators the authority to step in when the market is not competitive. He said that they favor use and file systems for personal rates and rates only should be disapproved if they are inadequate or unfair. He offered that the P/C trade groups could put together language for a model bill before the Denver meeting.

Ms. Kron and Mr. Skinner echoed Mr. Schmelzer's comments and assured the Task Force of their willingness to help to achieve speed to market for all.

Wesley Bissett of IIABA addressed the Task Force to express support for its mission to preserve and strengthen state regulation. Mr. Bissett said that the IIABA opposes federal insurance regulation and believes that it would not be good for agents, consumers or the industry. However, he said that state regulation is under siege by proponents of full-blown federal regulation due to real world problems faced by insurance companies.

Mr. Bissett urged the Task Force to look at a system that is more market-oriented, efficient and faster. Specifically, he encouraged the Task Force to look at the ALEC model for rates, which includes no pre-approval for rates but requires that they be filed for both personal and commercial lines. He said that Illinois stands out as a model, but other systems are similar, such as that of South Carolina. As for forms, Mr. Bissett endorsed systems that would require insurers to file forms for both personal and commercial lines but would allow them to be used within 30 days. He also encouraged legislative oversight hearings to ensure that departments continuously improve their systems and follow the mandates of statute.

Mr. Bissett encouraged the Task Force's work on the interstate insurance compact and suggested that they follow the principles outlined by Bob Zimmen that encourage states to move away from prior approval systems, incrementally if necessary.

Mr. Bissett concluded with two observations. First, he said that the task to move to a market-based regulatory system is made difficult by current market disruptions. Second, he said that companies need to be realistic in their expectations. He said that, if they are overaggressive, they will not get much done. He also noted that issues like credit scoring are distracting and that, if companies changed their basic models, legislators may be more receptive to broader areas of reform.

Commissioner Vaughan said that she was pleased to hear IIABA speak out so forcefully on market-based regulatory reform and hoped that these comments would translate to state action. Mr. Bissett

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said that the IIABA has been focused on producer licensing issues, but now is putting other issues on the front burner, as well.

Director Covington said that he is working with the industry with hope of making progress on personal lines reform. He said that he hoped a middle ground was possible, possibly flex rating.

Senator Hannon said that he had to leave to catch a train but wanted to share a comment from a front-page article in that morning's edition of the *Wall Street Journal* entitled "Bush Crackdown On Business Fraud Signals New Era." "In sum," read Senator Hannon, "the early 21st century may be turning into one of those periods in American history—such as the populist and progressive eras at the turn of the last century, and the New Deal of the 1930s—where exposure of corporate excesses during a period of loose regulation creates a political consensus for new government controls over business."

Mr. Skinner said that the industry has promoted its objective of an ideal system, but said that it often was a matter of degrees and that they would like to see progress. Mr. Schmelzer again asked if the Task Force would like them to prepare model language for the Denver meeting.

Representative Counts said that model language for the Denver meeting might be premature. Senator Larkin agreed and said that they had too much on the table already. Representative Counts said that he could see the industry's point, but he wondered, if the current system was so bad, why it was put in place initially.

Commissioner Vaughan said that prior approval systems evolved in the early part of the century following the San Francisco Earthquake of 1906, which bankrupted many insurance companies. New York began the practice of requiring insurers to join rating bureaus to prevent inadequate rates. She said that this was the system that was challenged in the South-Eastern Underwriters Association decision that allowed Congress to regulate insurance as commerce and led to McCarren-Ferguson in 1945. Now, said Commissioner Vaughan, the practice is entirely different. Companies have developed more advanced models to estimate future losses, and, even if regulators look at inadequacy, it is difficult to disapprove rates, she said. Commissioner Vaughan added that inadequacy issues now are handled by financial solvency regulation.

Representative Counts said that he may have spoken too soon about the industry's offer and said that they should draft language.

The Task Force adjourned at 5:04 p.m.