



SOCIETY OF ACTUARIES

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Is There A Spof In Your Future?

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Throughout the life and health insurance industry, complaints about the product filing and forms approval process under state regulation have been increasing. In earlier years, new products were relatively infrequent. Now, however, new products often are introduced several times a year. The complexity of products is also increasing, including new versions such as:

- Multiple underwriting classes for life insurance
- Variable life and variable annuities
- Minimum death benefits on variable products
- Universal life, with or without secondary guarantees
- GICS
- Equity-indexed annuities
- Long-term care

Current problems with product filing are due in part to the inherent nature of state regulation of insurance. There are fifty-one different jurisdictions, each with its own rules. Therefore, problems have accumulated to include the following complaints:

- Lack of uniform model standards
- Lack of uniform interpretations of models
- Variable quality of state departments
- Arbitrary unwritten standards
- Inconsistent standards from state to state
- Inconsistent standards within a department, depending on the analyst

- Inconsistent standards from one company to another by the same department.
- Impossibility of uniform national products
- Extra printing costs for different policy forms, rate sheets, and advertising
- Lost sales
- For investment contracts, difficulty in competing with banks and other financial institutions.

As a result, among some segments of the industry, sentiment has been growing for federal regulation of insurance, instead of the traditional state system. This tendency started with earlier hearings conducted by Congressman Dingell. His proposal for federal preemption originated with several major insolvencies. Even though the Republican-controlled Congress has been friendlier to state regulation, the seed was planted in the industry. Also, in the area of Medicare supplement and other health insurance under HIPAA, there is already an increasing amount of federal regulation and control.

In 2000, a new bill, Gramm-Leach-Bliley, governing financial services of banks and insurance companies, increased the federal role. It mandated that states take action in the areas of consumer privacy. Also, GLB mandated national treatment for insurance agent licenses. Within a short time, an agent who is fully licensed in one state, will be able to apply automatically for national licenses in other states. A new clearing-house, NARAB, will be set up to process these nationwide licenses.

The ACLI, one of the large trade associations, simultaneously began a project to deal with the problems of product filing. Its task force prepared a

systematic grading of various aspects of state regulation. These included product filing, agent licensing, market conduct, and company admission in other states. The report of the task force that analyzed these aspects concluded that product filing was by far the weakest area of state regulation. These conclusions were approved by the ACLI and submitted to NAIC leadership in a detailed report.

NAIC Reaction

NAIC LEADERSHIP WAS REASONABLY receptive to the criticisms in the report. Undoubtedly, this was partly due to the fact that the report had mentioned federal charters as one solution to correct deficiencies in state regulation.

Commissioners met to discuss the product filing and forms approval area. Initially, many commissioners preferred to give the domestic state more preference than currently. In other words, states where companies did business would defer and automatically accept products approved by the domestic state. This approach, of course, was subject to the criticism that some insurance departments were understaffed and did not review submitted forms in rigorous fashion. For any approach, there is still the problem that many NAIC models are not widely adopted.

Later, an NAIC working group prepared a "vision" statement to deal with product filing uniformity. It contained the following points:

- The new organization will be called "CARFRA," which stands for Coordinated Advertising, Rate and Form Review Authority
- Single point of filing
- CARFRA would be voluntary, so that states would not be required to join
- State insurance department volunteers would serve as the staff of CARFRA
- New standards, to be determined, would be used for policy form approval

- Most important, states could reject forms, even when approved by CARFRA

From the Dallas NAIC meeting in September 2000, the NAIC working group issued an expanded vision statement. Starting 1/1/2001, there would be a trial run of the new CARFRA organization. Ten states would participate: New York, Pennsylvania, Michigan, Texas, Oregon, Maine, and four others to be named. Four test products would be eligible for the single point of filing. Initially, it was not specified what products, whether life, annuity, variable, disability, or long-term care. The working group stated that their hope was that the trial run would be so successful that all states would want to join.

Also, the working group agreed with the ACLI report recommendation for further research on state authority. Some states already had blanket authority to delegate policy form approval. For other states, commissioners were concerned about the lack of positive authority. So far, the organization of state legislators, NCOIL, had been made aware of the attempt to gain uniform product filing. In the past, they were very sensitive about issues of state rights and protecting individual state authority. So far, they had not voiced any objections to the project.

Some people were surprised that several consumer groups were strongly negative about a single point of filing. They claimed that this was an industry plot to sell misleading products to consumers without prior approval.

Simultaneously, with this SPOF project, another NAIC project has begun involving national treatment of insurance companies. This did not directly stem from the ACLI report, but it was based on similar concerns over lack of uniformity in state regulation. This project would involve an interstate compact allowing uniform treatment of companies in certain areas. Primarily, this was aimed at company licenses in states and, at least for the moment, did not involve single point of filing. Eventually, there was a

possibility that product filing could be made part of the compact.

Eligibility standards were initially set for insurers to participate in the national treatment project:

- Size – A minimum requirement of \$100 million annual direct premiums, or a business plan to reach \$100 million within several years
- Risk Based Capital of at least 400%, based on the annual statement definition
- Clean statutory audit opinion

In Dallas, the reaction of the ACLI and other trade associations to the proposed CARFRA trial run was guardedly positive. However, several spokesmen stressed that for CARFRA to work, all states had to join and fully delegate the policy approval function to the CARFRA staff.

What Does The Future Hold?

Trade associations will closely monitor the trial run of CARFRA. Even before CARFRA can begin, the working group will have to specify what products will be eligible for the trial run. Also, standards for approval, whether NAIC model laws or other bases, will have to be established. This portion of the CARFRA structure will have to be completed in 2000.

Some people viewed this step as genuine progress towards greater uniformity in filing. However, others thought that the working group was naive in thinking that a voluntary organization would have any hope of evolving into a uniform, nationally accepted one.

During discussions of single point of filing, some industry segments hoped for a “file and use” approach in policy and rate approval. This would replace the prior approval approach, which often is quite rigorous among the larger states. In Dallas, for example, one spokesman from the property and casualty insurance industry pointed to one large state that currently employs a file and use approach for automobile insurance and rates.

There is continuing analysis of a radical change to federal charters and federal regulation. Congressional authorization would be needed for such a change. This outcome and how it would proceed is greatly dependent on which party wins the November election.

Key questions that are a part of any proposal for federal charter include:

- Would a new federal agency be established?
- Would NAIC model and standards be carried over?
- How would federal income tax complications from federal charters be handled?

Back in the state regulatory arena, the question of standards is very important. NAIC standards for product filing, including NAIC models, are in many cases not widely adopted. There is a very sensitive question involving whether a state should follow standards that it has not yet adopted.

The question of NAIC standards in general has broader implications, such as national treatment of insurance companies. For example, in the area of codification, NAIC standards have been very controversial. Two versions of an NAIC model investment law were both excluded from codification. With codification itself, it was not adopted as a required accounting approach for each state but only for disclosure of differences between each state's accounting practices and codification.

In summary, the possibility of uniformity in product filing and rate is a critical test of state insurance regulation. At this time, the outcome is highly uncertain.

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