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Session 61PD
The Future of Insurance Regulation–Federal Versus State

Track: Product Development

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Summary: Participants receive up-to-date information about the activities of the National Association of Insurance Commissioners (NAIC) Speed to Market Working Group, the American Council on Life Insurance (ACLI) Task Force on Product Regulation, and the regulatory structure that applies to financial services products (other than insurance).

MR. JONATHAN GAINES: We have with us Commissioner Diane Koken of Pennsylvania, and Drayton Nabers, the president and CEO of Protective Life Insurance Company. Commissioner Koken is co-chair of the NAIC working group for Coordinated Advertising Rate and Form Review Authority (CARFRA), and Mr. Nabers is a member of the ACLI committees on federal chartering and state regulation efficiency. Before we get started, I will try to condense 150 years of history into about two minutes, in order to set the stage for the principal speakers.

The subject of today's discussion is federal versus state regulation. To see how we arrived where we are, it's interesting to note that the first state insurance department was created in New Hampshire in 1851, 150 years ago. Many other insurance departments were soon created later in the 19th century.

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During all that time—up until 1944—the legal environment was such that there could not be federal regulation because there was no constitutional basis for it. This meant that if there was going to be any regulation at all, it would be by the state governments. The proliferation or the development of many insurance departments led to the formation of the NAIC in 1871. Its express mission was to promote coordination and consistency across state regulations.

As you can see, there's a long history—more than 100 years—of effort to create consistency in state regulation. I think the physical evidence of that is the four volumes of NAIC model laws, regulations, and guidelines, which govern how the business is run from a regulatory point of view in the United States.

There are, on the other hand, some negatives. Before I get to those, it is important to note that today, after all of this work, coordination, and regulation development, competition in the industry and between industries has become much, much greater than over the previous 100-plus years. We see that in the competition between the traditional insurance industry and banks, brokerage houses, and mutual funds. This has led to an increasing emphasis on innovation, flexibility, and speed-to-market, which in turn has increased the need for coordination and regulatory efficiency.

Again, a historical perspective may be helpful. In my home state of New York, for example, prior to approximately 1938, life insurance policy forms were established by regulations. The forms were literally adopted by the department as the policy forms—I think there were seven or eight of them—and there was no process for policy form filing and approval. However, that law changed in 1938, at which time the current form filing process was created.

I should tell you a little about my professional background at this point. I spent ten years as a lawyer at the Federal Trade Commission (FTC) before coming to the insurance industry. At the FTC I did mostly antitrust work, which necessitated learning something about economics. When you work for insurance companies, you learn a lot about actuarial science. In the economic context, competition tends to disaggregate products because companies are always trying to maximize the number of people who they can sell to, which they do by trying to hit everybody's price and/or value preference.

For example, if there was a population of ten million people, if one could afford it, there would be ten million products, each one designed for an individual. This would probably produce the most sales because it hits everybody's needs exactly. Competition tends to drive product development in that direction, which I think we're really seeing. We see a lot of disaggregation of products into components. Some of this began with Universal Life, but today, with all the various kinds of guarantees and alternatives offered with life and annuity products, we see a lot of mixing and matching. This makes product development very important; and it puts

a premium on innovation, flexibility, and speed-to-market. No longer do we have a single policy form that everybody uses; instead, we have thousands of different policy forms. Getting those things to market is the crux of being in business today.

From my point of view, the most important aspect of what the NAIC is doing to address these issues is the Coordinated Advertising Rate and Form Review Authority (CARFRA) initiative, which creates a single point of filing for a product. The idea is to try to file it once and get definitive approval. The ACLI is working very hard on that aspect, as it is making a great deal of effort to work with the NAIC to develop the CARFRA process. They have also been working on a proposed federal charter legislation, which was publicly released in the past month.

I'll now turn the discussion over to Drayton Nabers and Diane Koken, each of whom will talk about what his or her organization is doing.

MR. DRAYTON NABERS: In the year 2000, while I was chairman of the ACLI, we decided to make our number one priority the study of regulation–devising a solution to the specific problems we have had.

In January 2000, a group of us affiliated with the ACLI were privileged to meet with Commissioner Nichols, who was the president of the NAIC that year; Commissioner Kathleen Sebelius of Kansas, current president of the NAIC; and her successor, Commissioner Terry Vaughan from Iowa. We met to talk about our industry's challenges with regulation. What impressed me then and, in no respect have I changed my mind, is the commitment of the NAIC to work as hard as possible to come up with an acceptable solution to our problems with regulation. We don't want to see the ACLI's problem creating a we/they mentality.

The NAIC understands that insurance regulation needs to be improved. They understand the inefficiencies in the current system and are working very, very hard to come up with a solution.

We need to see this as a "win-win" situation. We need to work with the NAIC the best we possibly can to devise solutions, which is the commitment of the ACLI. I'm sure that many of you within your companies are working with the ACLI to devise solutions with the NAIC.

Nevertheless, the ACLI has determined to proceed on a dual-track process. The first track is to improve the present system by working with the NAIC to come up with prompt solutions, especially with respect to speed-to-market product approval, agency licensing, company licensing, and privacy and market conduct. The NAIC is focused on these problems and is working very hard.

The second track is to study an optional federal charter as part of the solution. In other words, introduce legislation to Congress that allows an insurer to become

federally chartered so it may operate in all 50 states. The ACLI has not made a decision to introduce the legislation, but over the last year, hundreds upon hundreds of representatives from our member companies have worked on about 35 separate task groups to develop the legislation, which was drafted in an eight-to-ten-month period. It has now been distributed to our members, the companies you work for.

As it is being vetted, we're getting feedback from the companies at this point, which indicates a high degree of satisfaction with the conceptual approach in the proposed draft. In other words, I think the groups you worked with that developed the proposed drafts are getting high marks for their solutions and proposed legislation. Sometime this year a decision will be made based on the input that the member companies are giving to the ACLI, and also economic factors. It will be costly if there is a federal regulator, as the federal regulatory system has to be supported with fees, and the political process needs to be analyzed as well. Is this something that is feasible? Membership input, political considerations, and economic considerations are all being studied within the industry and within the ACLI to determine what should be done with respect to the second track.

You all know that a watershed event was the passage of the Graham-Leach-Bliley Act (GLBA) legislation in 1999. If we can go back to our mindset in 1999, the insurance industry was in a very precarious situation because the controller of the currency was very aggressively pushing bank powers to participate in the business of insurance. Initially the controller advocated the power of banks to sell insurance outside of the state regulatory system, but already there had been overtures.

Also, the possibility was being developed to give banks underwriting authority—at least underwriting power with respect to annuities—and we ultimately feared other insurance products, which would have meant a dual regulatory system. All insurance companies would have then been subject to the state regulatory system with its problems, challenges, and inefficiencies; and banks would be on a parallel track doing the business of insurance with an entirely different and more efficient regulatory system. That, I think, would have been a real challenge for the insurance industry, but the GLBA legislation did away with that. It made it very clear that from there forward, regulation of financial services would be by function. Whether a bank, mutual fund, stock brokerage, or insurance company—if planning to do insurance, it would be within the regulatory structure of all other companies doing insurance. This legislation was a very important victory for life insurance because at least now there is a level playing field with respect to regulation. What the GLBA did not do in any way, however, was deal with the efficiency of the regulation. It instead opened up convergence of markets. Now banks, stock brokerage companies, and insurance companies can all compete in the same markets.

The barriers that had been created by Glass-Steagle back in the Great Depression were eliminated, but nothing was done about the efficiency of regulation. What we

found in the insurance industry, and I don't think our regulators disagree with this, is that we are encumbered with a regulatory system in the 50 states that is more complicated, more inefficient, and takes substantially longer than our competitors in the banking and mutual fund businesses, brokerage houses, and so forth. This is especially true with getting products to market. So, if one develops a product, say, in the retirement savings market, and it is to be sold as a security—but not an insurance product—it can get to market in three months. Through the SEC one can get almost any product ready for market in three months, and if it is a banking product, it takes several days. It's a 'file and use' sort of system.

For the work that Commissioner Koken is doing with CARFRA, it is about a 12-month process. Take American Express as an example. If one has a company through convergence that can develop a retirement savings product in a number of ways—to be sold through 401(k) plans, as an insurance product, or elsewhere—why would the company not invest its capital in the product that can get to market most efficiently? Of course a company is going to make that kind of decision. What we have with the convergence of financial services created by the GLBA is a situation in which insurance companies are currently at a competitive disadvantage because of the regulatory system. This is the situation we face throughout the industry and at the ACLI.

Now I've mentioned the ACLI's two-track process, and will talk about how the industry is looking at track two. The NAIC is making progress, but the question is, if the NAIC makes very good progress, will that be sufficient? There are at least some companies that want a federal charter regardless of how efficient the state system might be. I'm not going to talk about any one company, but, for instance, with the globalization of our business, there are a number of companies owned and controlled by European parents. European parents don't want to deal with 50 separate states no matter how efficient the process. They would prefer to deal with a single regulatory authority. By the way, in Europe there is far greater reciprocity, uniformity, and insurance regulation than in the United States. France and Germany have been fighting each other for centuries, yet they have, through the European Common Market, reached more commonality in insurance regulation than Indiana and Illinois have at this point. This is not to say Indiana and Illinois are not working, but we are behind in that regard.

Another factor is that some companies, especially the large, national companies, particularly those with an international presence, want to have an advocate in Washington. When issues come up that relate to banking and insurance, while the bankers have the controller of currency, the insurance companies have no one to speak for them. Some insurance companies see that there's a real advantage to having someone in Treasury who can be a spokesperson for them.

On the other side of the equation—and this does not apply to anyone in the leadership of the NAIC—from time to time we find ourselves with an insurance

commissioner who not only is not an advocate of the insurance industry, but who is also somewhat of an adversary of our business. This is because some of the insurance commissioners will criticize the insurance industry for political advantage. What some companies in the industry would like to have is a federal charter and a spokesperson in Washington who, on federal issues relating to financial services, will be a voice for the insurance business.

The point is that we're working on two tracks and a decision is still to be made by the ACLI Board on whether or not to seek an optional federal charter. There is a feeling among some companies that there's a strong urgency to seek that optional federal charter. A decision will be made by the Board on whether to go forward or not, I would think, by the end of this year, after the scheduled meetings in July and November. I think it is very likely that we will go forward.

I would like to talk about the political situation at this point. The American Banking Association (ABA) has a bill that it is poised to introduce, but the insurance industry does not want to mark the banker's approach to insurance instead of marking the insurance company's or the ACLI's approach to insurance. This is a factor outside of our control, and will have to be taken into account if banking legislation for the regulation of insurance (the ABA's bill) is introduced early.

There is the possibility that some insurance companies will act independently of the ACLI, although most of the large ones are ACLI members, and I imagine they will go along with the ACLI. We're not assured of this, and some large companies are not ACLI members, so there might be an insurance bill by an insurance company that is introduced apart from what the ACLI is doing. Also, there are some senators and other congressmen who want to take a leading position in all of this, so there will be hearings on insurance regulation and on an optional federal charter this fall, we think, regardless of what is done at the ACLI. Some momentum is developing that relates to the federal theater for insurance regulation—much of which has been prompted by the vetting of the ACLI proposed bill.

I would like to say a few words about the basic approach of the optional federal charter legislation draft that is now being vetted within our membership. We want to have essential charter neutrality. There is no desire or view that simply by being federally chartered, there would be some inherent disadvantage to the nature of regulation. The regulatory structure under the federal charter will be much the same as under the state charter. We will simply have one regulator rather than several regulators. In no respect is there an attempt to move toward what would be called deregulation of insurance. The same points, the same factors, and the same issues are going to be addressed by the federal charter—should there ever be one—as will be addressed under the state system.

This conclusion at the ACLI was based on a survey made by the member companies who came up with a scorecard of the current system. Fairly broadly, the

scorecard said that the substance of the present system was not the problem. The problem was the lack of uniformity. We didn't have uniform laws then, and even when we did, we didn't have uniform application of those laws. By the way, the NAIC agrees entirely with the ACLI that the objective of state regulation should be to have uniform laws and regulations, which will have uniform application. This is a very, very ambitious goal, but it is the NAIC's goal and they're working very hard under the leadership of people such as Diane to reach it, which we should applaud. Of course, if a company has a federal charter under the optional system, there would be broad preemption of state regulation, so a company would choose federal regulation with preemption of state regulation or state regulation without being subject at all to the federal regulations. Thus, the company would have two optional parallel systems. We already mentioned that the location of the regulator is at least in the draft that was being vetted, and that there was a lot of study in the ACLI relating to this in the Department of Treasury, where the regulation of banks is done through the Office of the Comptroller Currency (OCC). There would be a Division on Consumer Affairs relating to consumer protections, and for a five-year period, both federal regulation and state regulation would have, essentially, the same approach.

In other words, the federal regulator is required to use NAIC standards with respect to statutory accounting, risk-based capital, reserve valuation and non-forfeiture standards. Therefore, the idea is that if there is ever a deviation between the two systems with respect to critical things such as these things, there would be a long study period in the federal system before any separation or deviancy would happen between the federal and state systems relating to those factors. With respect to product approval, what is being vetted now ultimately results in a file certification by an actuary of compliance with the laws and then use rather than an approval system. Interestingly enough, in Pennsylvania—though not in all states—a 'file and use' approach is becoming more and more prevalent.

That is a brief overview of what is going on. The good news is that everybody, those in our industry and our regulators in the NAIC, knows that a lot of improvement must be made to insurance regulation. Whether or not a bill is filed and whether or not that bill ever becomes law, the ACLI is absolutely committed to doing all that it can to work with the NAIC to improve the current state-based regulatory system. Whatever we have with respect to federal legislation, the state-based system will remain in place just as it has with respect to banks; it will work with the NAIC to make it the most efficient and the best regulatory system we possibly can, in the best interest of us all.

Whether there will be an alternative and an optional federal charter depends on a number of events. I'm sure that each of you and your companies have your own opinions. We really don't know what will happen there, but we agreed that our current system is broken, it needs to be fixed and the NAIC and the ACLI are working as hard as possible to fix it. Both making a lot of progress. With that, I'll

turn it over to Commissioner Koken.
MS. DIANE KOKEN: Thank you very much. I really do appreciate the opportunity to be with you today. As Drayton indicated, this is an exciting time in the financial service marketplace, both for competitors and regulators. The significant transformations that are underway in the areas of rate and form filing, and company and agent licensing, really do affect all of us. No longer can we sit back and observe the changes. We have to embrace them. We have to move forward, or we are committing ourselves to being both irrelevant and obsolete.

Many commentators, in the wake of the GLBA, point to the passage of this legislation as the catalyst for changes being proposed, and those that are underway in the system of insurance regulation. I will not argue that the GLBA has not focused on convergence in the financial service marketplace. I do believe, however, that state insurance regulators—well before the passage of the GLBA—recognized many of the reforms that were being advocated by the insurance industry. State regulators understood these changes and began to look at the way we do business even before the law was passed. All of these efforts were designed to improve the uniformity and efficiency of state regulation: the creation of accreditation standards for financial solvency monitoring, the development of a more uniform set of licensing requirements for insurance companies through the Alert System, the development of uniform risk-based capital requirements for financial analysis, and initiatives to develop a national producer information network through a PIN system.

These efforts in no way minimize the active role played to make reform efforts more of a reality. But I also think it's important to realize that the states were not sitting back and waiting for Congress to mandate certain requirements. We recognize the same marketplace forces that Congress observed during the GLBA debate before November 12, 1999. There is no question that the market has changed. New mergers and acquisitions are being reported almost daily as banks, insurance companies and securities firms are expanding their markets. Technology is driving aspects of these relations such as industry-to-industry and the all-important industry-to-consumer relationships, as consumers still want more products at lower costs—and they want them now.

The passage of the GLBA signaled Congress's desire for all functional regulators to recognize these marketplace changes. That's the framework facing all of us: the insurance industry, consumers, and also regulators. Today, the GLBA is clearly the focal point of discussion about financial services regulation in the 21st century. As the seminal statement on this regulatory framework, it is important to make clear what Congress explicitly said in the GLBA; states are the functional regulators of insurance. It reaffirmed the McCarran-Ferguson Act (MFA), which, as you know, recognizes the primacy and legal authority of the states to regulate insurance activities. Additionally, the GLBA gave state regulators an immediate opportunity to address uniformity and the issue of privacy under Act V. The states are working

uniformly not only to pass NAIC model language on privacy, but also to develop, as Drayton indicated, uniform interpretations of the language to ensure a more consistent regulatory environment.

The GLBA has brought many changes to the financial services industry as a whole, but it has also sent a very strong message to regulators, those of us who are accountable to consumers. This message extends to all regulators, not only insurance regulators. Beyond technical law requirements and directives, the GLBA made it clear that we all need to work together to make sure our regulatory systems are coordinated, efficient and responsive to the current realities in the insurance marketplace. NAIC members are taking this message seriously, and I will briefly discuss with you some of their efforts.

By now, most of you are aware of the NAIC statement of intent, which was our blueprint for the modernization of state insurance regulation. An often-overlooked aspect of this initiative is the fact that commissioners representing all 50 states and the District of Columbia physically signed that document. That's quite a statement, I believe, of our commitment to these reform initiatives. If we give industry advocates a blank piece of paper and ask them, "What kind of reforms do you want," they will tell us they want streamlined, real-time producer licensing. They would say they want help bringing their products to market faster. They would say they want fair and efficient regulation. That's what those of us who are elected or appointed to hold the industry accountable want also. And now we're putting our statement of intent pledge into action after we signed it one year ago last March.

I will now give you a quick look at what we did over the past 15 months. Just a year after the adoption of the NAIC's Producer Licensing Model Act (PLMA), more than the requisite number of states are on track to meet the producer licensing requirements of the GLBA. The model creates uniformity in agent licensing procedures, simplifies the licensing process and promotes reciprocity while it preserves states' rights and eliminates retaliatory fees. To date, 35 states have enacted laws satisfying the GLBA reciprocity requirements. In addition, bills are pending in ten more states this session. The National Insurance Producer Registry (NIPR) was launched to create a single point of licensing for agents in all 50 states. After an eight-month public process, in September 2000 the NAIC achieved unanimous adoption of GLBA-like model privacy regulations that ensure a level playing field from the financial services sector. As of April 2001, 36 states reported that they would enact financial privacy protections based on the GLBA/NAIC model regulation. Moreover, the NAIC model regulation singles out health information for additional opt-in protection, without undermining the business of insurance.

The NAIC negotiated model information-sharing agreements with federal regulators. Individual states are in the process of signing agreements with each of our federal regulators to facilitate the exchange of regulatory information and thus ensure better supervision and coordination. These regulators include the Office of the

Comptroller Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Reserve and the FDIC. Many NAIC members are meeting regularly with federal regulators for sessions such as cross training and education. Members have shown increasing leadership in international regulatory discussions also. The NAIC is now proposing new federal legislation to create regulatory efficiency, improve dialogue and fight fraud.

The National Treatment and Coordination working group is focused on increasing efficiency and consistency in company licensing, corporate government and the review process of Form A filings or statements concerning the acquisition and control of a merger with a domestic insurer. To that end, the working group is developing a Form A database to facilitate information sharing on acquisition and merger filings. This system will be used by states to identify other Form A filings submitted by the same or related parties. Bringing greater coordination to these filings will produce a streamlined regulatory process that maintains the integrity of state holding company laws, while being responsive to a dramatically evolving industry. The group plans to have the database up and running by March of next year.

I want to touch upon one last reform effort, in which I have had a great deal of involvement; that is the issue of speed-to-market. As some of you know, I co-chair, along with Commissioner Frank Fitzgerald of Michigan, the original speed-to-market working group established by the NAIC's statement of intent. One of the primary tasks facing the original group was to determine collectively what multi-state regulatory processes and procedures would look like. The group's goal was to maximize state cooperation and to share best practices that let regulators embrace a consistent process allowing for appropriate and efficient rate and form review. The original group has now been transformed into these two entities: CARFRA and IS3, which work toward improvements to state-based systems. CARFRA, with Pennsylvania and Michigan representatives as co-chairs, is designed to meet consumers' needs by speeding new products to market while maintaining the appropriate regulatory review. CARFRA gives insurers wishing to market products on a national or multi-state basis a voluntary single point-of-entry to submit certain products for review, with a certainty that a filing can be approved for multiple state uses. On May 1, 2001, a limited launch had begun in 10 states for a single point of filing speed-to-market initiative. Those states comprise 35 percent of the national premium volume. More states and products will be added this year.

CARFRA utilizes the NAIC's system for electronic rate and form filing, SERFF, to accept and process filings. Goals of the program include greater efficiency and agreeing on a 45-day national review timeframe. Minimum qualifications for reviewers have been established. Each product coming into CARFRA will be reviewed by a panel of five states, thereby actually increasing the expertise of the review of the filing. CARFRA provides a single point of filing and review along with national standards for insurance products. The process is initially focused on life and

health products—annuities, Medicare supplements and term-life—but we believe that it can also benefit certain property casualty products, which we will be expanding in the future. By July 1, 2001, we will decide on the next products that will be added to CARFRA.

State deviations from the established national product standards have also been published and are accessible to all companies. Companies can file products to meet the national standards, and specific state filings are designed to comply with any state deviations. Companies can certify to a state that deviations have been met, and under CARFRA, states are allowed to accept those deviations as certified.

I am excited to announce that just last week we had our very first filing in CARFRA. During the development of the CARFRA process, some people have commented that the existence of state deviations to the national product standards means that a state system cannot work to develop a national standard for product review.

I disagree. While we are aware that deviations exist, we also know that the first step in bringing greater uniformity to form review among the states is to identify our differences and to make certain that such differences are the result of actual state laws and not the whim of individual regulators. Already CARFRA is working to promote uniformity by offering a forum to review deviations and to discuss ways to minimize the differences. The improvements to a state-based systems group are focused on improving operational efficiencies of regulators in the rate and form reviews and to assess various regulatory framework efficiencies that will also improve the speed and quality of review among the various states.

Specifically, we are focusing on improvements that can be made to current state-based regulatory systems for product review. We intend to address those product filings that will remain subject to state-based filing review. Our goal is to create a more efficient state-based filing and review process that provides for consumer protection while offering uniform and consistent speed-to-market. We are developing a framework that will be used to commit states to implement the various recommendations for efficiency that the subgroup developed. We are also developing a transmittal and review standards checklist, which is designed to assist state regulators in reviewing insurance product filing more efficiently and effectively. Currently, states are completing their review standards checklist for property and casualty products. These checklists will be posted on each state's Web site and linked to a map of the states on a NAIC Web site for easy access for everyone.

I would say that our good intentions have led to effective actions, which is a lot of movement in just a little more than a year. It is my strong belief that the state system of insurance regulation has worked effectively in the areas of financial solvency, market conduct and consumer protection. However, it must continue to evolve to meet the needs of the insurance marketplace in the 21st century, but it is also moving to meet the new challenges that competitors in the financial service

marketplace are demanding of us. It is a system that requires constant self-analysis to make certain that it is meeting its customers' needs. My opinion is that system does not need to be dismantled and replaced—just improved.

Insurance is important to people. Consumers can't drive a car, buy a house or open a business without having good and affordable insurance. An insurance commissioner's overriding concern is protecting the consumer in all of these situations. Solvency regulation, yes, but ultimately this means taking care of your next-door neighbor, your child, or your grandmother when catastrophe strikes or they have been wronged. The states have 150 years of experience ensuring the solvency of insurance companies, while looking out and protecting the interests of consumers. Having similar processes with local control is really the best of both worlds.

Consumers need to have confidence that the people regulating their policies have an understanding of their local problems. In addition, we have a system of more than 10,000 people around the country responding to local consumer issues on a local basis every year. They answer questions and make sure claims get paid and products are sold fairly. In 1999 alone, state insurance departments handled 448,000 consumer complaints. They initiated 116,000 license cancellation suspensions or revocations and they suspended 113 certificates of authority. The bottom line in our opinion is that there are no national consumers. Insurance is a local product that needs local regulation. It's like calling 911. Do you want that to be a local call or do you want that call routed through Washington, D.C.?

Very recently I found myself confronted with the largest financially troubled company in the United States property casualty industry. I have learned from this experience that we, in Pennsylvania, have the tools to take decisive action to stabilize the enterprise. We have the solvency measurement tools, we have the rehabilitation tools, and we have the financial analysis expertise. I sincerely doubt whether an alternative regulatory structure would have handled the situation differently, and in some ways I might question whether an alternative system could act as swiftly or decisively as we have acted.

In closing, I would like to say that state insurance regulations best serve their constituents by being responsive to individual consumers, being sensitive to changing markets and encouraging insurance innovation. Those characteristics are not frequently associated with federal regulatory agencies, but state regulators are in touch with what is going on within each state. Through the connection with the NAIC, they are also up-to-speed about what is happening around the country.

Together the states are moving towards the direction of uniformity, which will make it easier for the business of insurance to be conducted across the United States. This effort must first be addressed at the state level in order for the states to work together towards the most effective process for all parties affected—the

insurance industry, consumers, and regulators.

I take great pleasure in meeting with industry groups, not only so that I can share information with you, but also to gain information from you because I know that we share ultimately the same goal—providing the insurance-buying public with the best available products at a competitive, actuarially-sound price.

MR. GAINES: Thank you. We have time for some questions.

MR. BRUCE DARLING: I'm with a unit of AON Consulting called Book Seminars; we teach insurance accounting seminars, both statutory and GAAP. I have a couple of questions. First, in the federal regulatory alternative path, in consideration of the form of accounting and reporting for those federally chartered companies, would they continue to have statutory accounting or parallel this in some way? Or would they have their own version of GAAP or statutory that they would require?

MR. NABERS: Yes, the federal system will use statutory accounting for a mandatory five-year period, so current NAIC conventions for statutory accounting will be used in the federal system. This gives the federal regulator a long period of time to consider whether some other system might be sufficient or better. However, for a five-year period, the current NAIC statutory accounting would apply to federally chartered companies.

MR. DARLING: Commissioner Koken, I'm not sure whether or not I heard you endorse the ACLI's proposal. Is your position that it's a good idea or not?

MS. KOKEN: I think that it is fair to say that the ACLI's draft proposal is quite thick, and I know that we have not completed our analysis. Generally it is safe to say that the focus is and should be on improving the state-based system, that it is going to be a quicker, and ultimately better, approach for the consumer if we spend our energies on improving that system.

MR. DARLING: Mr. Nabers, it seems like the last time I saw a large proposal like this was the Clinton Health Care Initiative, which was dead on arrival in Congress. Do you think that there are sponsors in Congress or do you think that Congress would be receptive to a proposal of this nature considering that it appears that they like to author everything?

MR. NABERS: There is considerable interest in Congress, with moving forward to a thorough study of the ACLI proposal. I will say that the proposal is well-grounded in reality because it came from the industry with a full view of what is required for a coherent, effective regulatory system. I think it is a very good draft proposal and that is what determines whether it passes or not will more be political considerations than the actual merit of the bill itself. I think the bill is very well thought out.

MR. DARLING: I imagine that with all the contribution to the drafting process, the political implications would be somewhat iffy. My last question is once we have such a federal commission of insurance, do you think that the executive, and eventually the legislative branches of the federal government will be satisfied with just regulating the couple of companies that wish for the federal charter? Or, do you think they will chaff under the limitation that they're not representing all the other insurance companies?

MR. NABERS: I think the most appropriate model for understanding the system, which is proposed, is banking regulation. As you know, there is an optional dual system for regulation of banks. Interestingly enough, that ebbs and flows. Over the last several years, a number of reasonably large federally chartered banks have become state chartered. I don't know if the division is measured by assets, but I think it's measured by number of banks. The number of banks that are state chartered is roughly equal to the number of banks that are federally chartered. This allows the federal system to work with a division of responsibility of both state and federal, which works very well in one of the financial services industries of enormous importance to the country.

MR. DARLING: Is there a place for those of us who are not members of ACLI to get a copy of the proposal?

MR. NABERS: Yes. Go to the ACLI Web site: www.acli.org.

MR. PERRY KUPFERMAN: I'm with Protective Life Corporation. There are two issues that have come, I think, largely from federal involvement that are of some concern to me. I'm curious, Commissioner, what your comments might be. I'll state them in a fairly biased perspective because I am concerned.

The first is that the national banks have gone to a product called either debt cancellation contracts or debt deferment contracts. These are obligations in which they choose to waive, instead of insure, the obligations of their customers. This seems to me to be an unregulated form and rate which is not subject to premium tax, and as you point out, gives an undue advantage. It eliminates the requirement to license, and it eliminates involvement of agents and brokers.

The second example I will cite is something called a risk retention group, which is a fairly unregulated alternative to an insurance company. It's formed with little indication of strength or discipline. These are basically unregulated organizations that are allowed to compete with insurance companies in a number of lines of business. I believe that they seem to be considered today to be a viable alternative to an insurance company, which has solvency and regulation.

MS. KOKEN: You raised some very good topics. I think, though, the bigger issue is that you point out the concern of how do you determine in a functional regulation

setting who regulates what. Clearly, in the past, if an insurance company sold a product, we said that the insurance department regulated it and if a bank sold a product, we said that the OCC or the OTS or whomever regulated the product. It was not easy, but it was easier to determine. Under the new regime of functional regulation, it becomes much more difficult to determine if certain products that are being sold by insurance companies and/or products that are sold by banks should be subject to insurance regulation.

Clearly the two issues that you talked about, in particular, the first one, generated a fair amount of discussion at the recent NAIC meeting. Also, there have been a lot of letters coming across my desk on the whole debt cancellation issue. We have, in fact, begun working much more closely than we had worked historically with our fellow regulators on the whole area of functional regulation. We are looking at what they do and what we should do, and are discussing how to define insurance.

MR. JEFF ROBINSON: I'm from the consulting firm of LIFE. The IRS sometimes determines what's insurance and what's not. I don't know where they stand on it, but they could level the playing field. Two questions: Where do the agents stand on all of this? They are a rather important, strong lobbying force. The second question is, what are the political issues involved here, except control?

MR. NABERS: First, with respect to the agents, they have not weighed in one way or the other. I think they are on the sidelines at this point. Although, if a bill is introduced, I am sure they will comment and take a position on it. Insofar as the politics are concerned, there's one obvious position—that Republicans are much more prone to pay attention to the state regulation than Democrats are. I think that Democrats will probably be a little more open to the concept than Republicans. I'm sure Republicans want to look at progress being made by the NAIC in considering any federal alternative. Consumer issues will be important. Diane is right to say that the current system does protect consumers well. I don't know where consumer groups will ultimately be, but I do think that the consumer protection parts of the bill are things that Democrats are going to pay a lot of attention to. So, if Democrats are going to support some things like federal legislation and optional federal charter, then I think they will be very, very cognizant of which consumer protections are in the bill.

I think that by any realistic assessment, if such a bill were to be introduced to Congress—and it will be introduced, whether by the ACLI or another group—it will take a long period of time for Congress to become advised and comfortable with what is involved in the federal legislation. So I think three or four years is probably the earliest timeframe in which one could expect such legislation to pass. It could be six or seven years, and it could be never. I think that the political landscape is still somewhat uncertain.

MS. KOKEN: I don't disagree with anything that Drayton said. The other issue,

though, is that there are a lot of discussions based on the size of the company and the industry. For example, in Pennsylvania we have a fairly large number of fraternal organizations, and we have 350 domestic companies. They have a great deal of access to their local state regulators. There's not a company that can't call up and get an appointment to meet with me and talk about a concern, an issue, or a perspective that it wants to get across.

There's a particular concern for the smaller companies, that having a federal regulator is going to eliminate their access, other than through certain types of trade groups, because it will be more difficult for them to have the size and financial backing to warrant the federal insurance regulator to give them an appointment.

There are 1,700 companies that do business in my state and I think there are approximately 5,000 companies in the United States that do business and there is a fair amount of access engendered by a lot of constituent groups in having insurance regulated on a state basis. Some people think that's good or bad. It certainly creates more difficulties for large insurers that then need to access on a broader basis. I think that's what the whole goal of developing more uniformity and consistency is designed to address, while continuing to keep the regulators close enough to the consumers and the people to understand the concerns of consumers as well as the concerns of their industry in their location.

MR. ROBINSON: Where will this start, in the House or in the Senate? And are there different positions from both houses?

MR. NABERS: I think that hearings will occur simultaneously in both the House and the Senate. I don't think there's a constitutional requirement, as with an appropriation bill for it to begin in one House or another, but there are hearings, as we speak, going on in the House. I think there was testimony yesterday from the industry relating to federal regulation, yesterday and today as well, and we fairly assured the industry that after the August recess, there would be at least one senator who will commence hearings. This way, you'll have simultaneous development of the bill in both the House and the Senate.

MR. ROBINSON: This is for Jonathan. Speaking of foreign countries, how does New York feel about all of this?

MR. GAINES: I think that the superintendent in New York is very much in favor of the CARFRA process and is working actively to try to make it work.

MS. KOKEN: Actually, Superintendent Serio is from one of the 10 states that are the initial CARFRA members. New York has very much committed a great deal of effort in re-looking at their process. The CARFRA states include Pennsylvania, Michigan, New York, Texas, Oregon, Maine, Alabama, Arkansas and Ohio.

MR. CHARLES WILLIAMS: I'm from Tillinghast-Towers Perrin. I just moved from Wisconsin to New Jersey and one of the things I'm finding out is I now have to replace my auto insurance, my personal liability insurance, and my homeowner's insurance because my company is not licensed in the State of New Jersey. I want to hear your comments about to what extent federal regulation versus state regulation would allow companies to more freely operate in all 50 states.

MS. KOKEN: I guess the point is that today nothing prohibits a company from getting licensed in all 50 states, if it chooses to, and we are taking steps to make that process much easier. Part of that is also in the Alert System. I'm not sure there is a reason why we would want to require all companies to do business in all states. There certainly are a lot of regional niche companies that serve an important marketplace concern by being smaller and focusing on particular areas, but I'm not sure that it is not a decision of the company. What we're trying to do is make it easier for companies that decide they want to do business on a national basis to do so, but that's not going to mean that all companies will follow.