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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

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Mr. Jeffrey Stoltzfoos
Senior Advisor
Office of the Assistant Secretary for
Financial Institutions
U.S. Department of the Treasury

Mr. Mario Ugoletti
Director
Office of Financial Institutions Policy
U.S. Department of the Treasury

RE: TREAS-DO-2007-0018

Mr. Stoltzfoos and Mr. Ugoletti:

The National Association of Mutual Insurance Companies ("NAMIC") is pleased to offer comments in response to the Department's request for comment on the regulatory structure associated with financial institutions.

NAMIC is the largest full-service national trade association serving the property/casualty insurance industry with more than 1,400 member companies in the United States. NAMIC members are small farm mutual companies, state and regional insurance companies, risk retention groups, national writers, reinsurance companies, and international insurance giants.

Executive Summary

As Treasury contemplates reform of the nation's financial services sector, including regulation of insurance, it is essential to consider what the best structure is for all constituents, including consumers, taxpayers, insurance companies, agents and others affected by the insurance underwriting process. NAMIC's conclusion, reached through years of member involvement and research, is that a reformed system of state insurance regulation - with an appropriate role for congressional

oversight and involvement and national standards for non-insurance specific business process issues - is the best structure.

Although the general scope of the request for comment is specifically directed toward reform of the "process" or "structure" of regulation, NAMIC urges Treasury to carefully consider the scope and philosophy of regulation and adopt principles and structures that facilitate open competition. Excessive costs and market inefficiencies experienced in the insurance industry result in large part from misguided regulatory philosophies and policies that hamper the free market operation.

NAMIC believes that states should have the primary role in regulation of insurance and that any significant reforms should take place at the state level. While NAMIC opposes federal regulation of the property/casualty industry, we acknowledge that there are areas appropriate for federal involvement, including Terrorism Risk Insurance, flood insurance, privacy and credit standards, and regulatory coordination with the states.

In considering regulatory reform, NAMIC also urges Treasury to acknowledge and preserve proper legal protections, such as appropriate privilege and confidentiality provisions, essential to business operations.

General Issues

1.1: What are the key problems that need to be addressed by our review of the current regulatory structure for financial institutions?

The central issue in the current regulatory structure is the underlying philosophy of financial services regulation. Free market, competition-based economic structures coupled with a regulatory structure that emphasizes safety and soundness and prompt corrective action should be standard for a modern, vibrant, competitive regulatory structure capable of governing in the twenty-first century marketplace. From a property and casualty insurance industry perspective, the key regulatory problem continues to be an over reliance on outdated and inefficient price and form regulation. To achieve the paramount objective of preventing market failure and encouraging competition, it is imperative that price regulation for all property-casualty insurance lines end. Regulators should facilitate a vibrant marketplace that relies upon competitive forces to set prices. As Treasury reviews the regulatory structure, barriers to true competition are the overriding problem that must be addressed.

1.2: **Over time, there has been an increasing convergence of products across traditional "functional" regulatory lines of banking, insurance, securities and futures. What do you view as the significant market developments over the past two decades and describe what opportunities and/or pressures, if any, these developments have created in the regulation of financial institutions?**

The passage of the Gramm-Leach-Bliley Act (GLBA), financial services modernization legislation, opened the door for greater integration within the financial services industry and convergence of products and services. Despite the projections for significant integration between other financial services firms – e.g., banks, securities firms – and insurers prior to the passage of GLBA there has not been widespread integration or convergence of products within the property and casualty sector. Joint marketing agreements and affinity projects are evidenced, but large acquisitions or mergers have generally not occurred.

There have been market developments over the past two decades, however, that have presented specific opportunities and challenges for the insurance regulatory system. Examples include:

- Increased use of internet marketing and sales have challenged traditional state borders;
- Greater frequency and severity of natural catastrophes are taxing the resources of insurers and states
- Regulation through litigation presents significant challenges for insurers and regulators.

Regulatory processes must be flexible and dynamic to meet the changing market conditions and strong enough to avoid abrogation to the courts.

1.2.1: Does the "functional" regulatory framework under which banking, securities, insurance and futures are primarily regulated by respective functional regulators lead to inefficiencies in the provision of financial services?

Following the Supreme Court decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944), that insurance was "interstate commerce" and subject to regulation by the federal government, Congress, in 1945, enacted the McCarran-Ferguson Act (15 USC 1011, et seq.). The McCarran-Ferguson Act recognized the local nature of insurance and provided for the continued regulation of insurance by the states coupled with a narrow exemption from the general federal antitrust laws.

The state-based functional regulatory system and the corresponding application of the McCarran-Ferguson Act limited federal antitrust exemption has worked well for decades to promote and maintain a healthy, vibrant and competitive insurance marketplace. There are more than 7,000 insurers operating in the United States, the majority of which are relatively small. A number of studies over the years, including those done 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.

The insurance industry lacks consensus regarding regulatory structure; however, there is general agreement among stakeholders – insurance companies, agents and brokers, regulators, state legislators and consumers – that reform and modernization of the current insurance regulatory system is essential to meet the needs of the twenty-first century marketplace. There is broad agreement regarding the principles of sound financial regulation.

Inefficiencies in the insurance marketplace are less the result of the current functional regulatory framework, than the philosophy and execution of the regulatory objectives. Current inefficiencies in the insurance marketplace are driven by excessive rate and form regulation, which hamper competitive pricing, inhibit product and service innovation, and delay product delivery. Consistency, while desirable and cost effective, will not in and of itself lessen the marketplace inefficiencies resulting from regulatory models that do not uphold competitive economic principles.

Uniformity is beneficial and achievable where state needs are similar and unnecessary regulatory differences significantly impede effective competition within the existing functional regulatory framework. Solvency regulation, for example, in insurance is basically uniform among the states. Financial reporting standards and financial examination standards do not suffer from inconsistencies and vagaries among the states. In more recent years, insurers, regulators and legislators have turned their attention to promoting greater coordination and uniformity in other aspects of insurance regulation beyond financial reporting and solvency. Certain members of the insurance industry advocate an optional federal charter as the solution; however, a variety of other approaches are viable, including domiciliary deference, interstate compacts and model laws and regulations.

1.2.3 Many countries have moved towards creating a single financial market regulator. What are the strengths and weaknesses of these structural approaches and their applicability in the United States?

A single financial market regulator would prove more problematic in the United States than in other countries. Unlike the majority of countries which utilize a unitary legal system, the United States has 54 well-defined jurisdictions each with its own set of laws and courts. As noted, the U.S. system of contract law is deeply developed, and with respect to insurance policies is based on more than a century of policy interpretations by state courts. The tort system, which governs many of the types of contingencies at the heart of insurance claims, particularly those covered by liability insurance, is also deeply based in state law.

There are also significant differences between insurance and other financial services and products which necessitate specific regulatory treatment. Geographical and demographic differences among states would similarly pose additional difficulties for a single financial market regulator.

1.3: What should be the key objectives of financial institution regulation? How could the framework for the regulation of financial institutions be more closely aligned with the objectives of regulation?

The classical rationale for regulation of financial institutions is that it should serve the public interest by efficiently mitigating market failures. For regulation to achieve this objective, however, there should be substantial evidence showing that existing or proposed regulatory interventions will efficiently address the failure. In other words, efficient regulation necessarily involves matching the appropriate regulatory tool to the specific market failure. Moreover, the benefits of regulation should outweigh its direct and indirect costs.

Given that property-casualty insurance markets exhibit high levels of competition, persistence of price and form regulation in insurance regulation cannot be justified as a response to market failure; it is rather a product of interest group pressure in the political process. To align insurance regulation with its paramount objective of preventing market failure and encouraging competition, it is imperative that price regulation for all property-casualty insurance lines must end. While several states have enacted reforms in recent years, more must be done.

Although insurance price controls are the most dramatic example of regulation that must be aligned to objectives, other examples also deserve attention. These include uniformity with respect to producer licensing laws, form filing procedures, underwriting restrictions, expensive and otherwise unwanted coverage mandates, and arbitrary and redundant market conduct examinations.

1.3.1/1.3.2: How should the regulation of financial institutions with explicit government guarantees differ from financial institutions without explicit guarantees? Is the current system adequate? Is there a need for some type of market stability regulation for financial institutions without explicit Federal Government guarantees?

Although solvency and financial integrity are essential in the regulation of financial services industries, the level and degree of regulation of financial institutions with explicit government guarantees differs from that of financial institutions without the same governmental financial responsibility.

A centerpiece of the state insurance regulatory system is the existence and operation of state guaranty associations. State guaranty associations provide a mechanism for the prompt payment of covered claims of an insolvent insurer. All states and territories, with the exception of New York, have created post-assessment guaranty associations. In the event of insurer insolvency the guaranty associations assess other insurers to obtain funds necessary to pay the claims of the insolvent

entity. In the case of New York, the New York Security Fund and certain funds which cover only workers' compensation utilize a pre-assessment mechanism.

Insurance companies writing property and casualty lines of business covered by a guaranty association are required to be a member of a guaranty association of a particular state as a condition of their authority to transact business in that state. Guaranty associations assess member insurers based upon their proportionate share of premiums written on covered lines of business in that state. Separate life and health insurance guaranty association systems also exist.[1]

Specific association operating plans detail provisions that establish procedures for handling of assets, filing of claims, and making assessments. With the exception of the states of California, Michigan, New York and Wisconsin, the guaranty association acts of the states and territories are based on, and are similar in most respects to, the NAIC Model Act.

State legislators and regulators have crafted statutes and regulations regarding the creation and operation of the funds based on the specific needs of policyholders and in coordination with state laws. The funds operate to ensure payment of claims by other industry participants, rather than a state or federal financial backstop. The insurance guaranty system, and the state regulatory and oversight structure, functions well for insurers and consumers. The current system avoids catastrophic financial loss to certain claimants and policyholders and maintains market stability, without governmental financial guarantees. As such, regulation and oversight of the guaranty fund system is appropriate at the state level. Creation of regulatory oversight mechanisms at the federal level is unnecessary and inappropriate in the context of the "industry-funded" state-based system.

1.3.4: What are the strengths, weaknesses and feasibility of a "principles-based" approach and could it improve U.S. competitiveness?

The current legal and regulatory system in the United States is primarily "rules-based." Recent attempts to adopt "principles-based" approaches have been to add to, rather than replace existing "rules-based" regulations.

NAMIC supports efforts to streamline the regulatory process and provide greater flexibility to respond to rapidly changing economic and market conditions. However, as regulators evaluate "principles-based" regulation careful attention must be given to legal and operational issues. Regulatory or accounting decisions based on principles, however, may not always be transparent or consistent with one another, and this can have significant competitive effects.

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[1] Florida, New Jersey, New York and Pennsylvania maintain separate associations for workers' compensation and New Jersey also has established a separate association for surplus lines coverages.

Legal certainty is also a serious consideration when developing and implementing principles-based regulation. Whether a particular way of doing business conforms to the principle involved can be a matter of a particular regulator's opinion, and as regulators and circumstances change, so do interpretations. In addition, civil liability concerns must also be addressed if principles-based regulation is adopted. In the United States companies are subject to liability in private class actions in both federal and state courts, civil rule enforcement by federal and state regulators, and criminal enforcement by both the U.S. Justice Department and state attorneys general. Lack of legal certainty could create extreme vulnerability for regulated firms if not properly addressed in conjunction with such a shift in the regulatory paradigm. NAMIC urges regulators and lawmakers to carefully weigh all issues, including ensuring proper legal protection and regulatory transparency and avoiding arbitrary regulator conduct.

Recently the New York Insurance Department released a proposal to establish principles-based regulation. The 10 proposed principles for insurers include maintaining adequate financial resources; paying due regard to the interests of clients; observing proper standards of market conduct and managing conflicts of interest fairly. Principles for regulators include ensuring that decisions are independent and objective; that new regulations pose no undue administrative burden; and that innovation and competition are encouraged.

Other alternatives also meriting consideration include prudential regulations which focus on compliance and risk-based regulations in which regulators focus on safety, soundness, and cost-benefit.

1.3.5: Would the U.S. financial regulatory structure benefit if there was a uniform set of principles of regulation that were agreed upon and adopted by each financial services regulators?

Despite the significant differences in various segments of the financial services sector, there are certain basic principles of regulation that should be common across the functional lines. First and foremost, financial regulators should agree upon and adopt a competition-based model for operation and regulation. Such reform would allow companies the opportunity to enter more markets with fewer impediments, protect consumers by ensuring fair market prices and creating more choices, and freeing more regulator resources to enforce proper conduct in the marketplace.

A true, open competitive pricing and service system, based on a set of principles emphasizing efficiency, remediation and better service to consumers should be the underlying basis of regulation across the financial services industry. Open competition models in which rates and forms are allowed to be determined by the marketplace is not tantamount to no regulation as some would argue, but rather will allow the financial services industry to thrive and grow while permitting regulators to focus time and resources on more appropriate regulatory activities.

Looking forward, a viable system of insurance regulation for the twenty-first century marketplace must be based on a new regulatory paradigm that adopts an "open competition" approach to rate and policy form regulation. Under such a paradigm, insurers should be permitted to enter new markets with a minimum of difficulty and "prior approval" should be eliminated as the standard for rate and policy forms. Regulators similarly should adopt a principle of regulation that focuses regulatory resources where needed. Targeting market conduct and other examinations based on analysis of risk and company conditions would free up regulatory resources to focus on critical issues and lead to a better level of regulation.

In developing regulatory processes to meet consumer and market needs, the financial regulatory structure would also benefit from uniform and consistent acknowledgement and application of fundamental business legal protections, including confidentiality and privilege provisions, due process rights to withhold production, trade secrets, and self-evaluative audits to safeguard the legal and intellectual property rights of financial services entities.

There is widespread concern, particularly among insurers, that the privilege associated with documents routinely produced, obtained or disclosed by regulators is not being maintained. Similarly, regulators across the sectors should uniformly agree to limit the discretion of third party contractors in the conduct of examinations of financial services entities and to control the costs associated with their use.

An increasing number of third party contractors are utilized to perform financial analysis or market conduct examinations. In addition, information is often shared with other entities, including quasi-governmental organizations and foreign jurisdictions, exposing the documents to subpoena or discovery in private civil actions. Although regulators often enter into "confidentiality" agreements with these third parties, courts have consistently held that privilege is vitiated when privileged information is provided in such fashion. In addition, the insurer or other financial service entity is not a party to such agreements and as such has little or no remedy if the agreement is deficient or breached.

1.4: Does the current regulatory structure adequately address consumer or investor protection issues?

As noted in 1.3, in the case of property and casualty insurance, state insurance officials and attorneys general play complementary and mutually supportive roles in consumer protection. The current regulatory structure works well to address consumer protection issues. State officials are keenly attuned to the needs of their residents, and are accountable and accessible¸ both geographically and politically, to their consumers.

The first and foremost consumer protection in the context of the provision of insurance is ensuring the ability of the insurer to provide the guaranteed coverage or service at some future date. Thus, ensuring the solvency and financial integrity of

the financial service provider is the fundamental consumer protection. In addition states have adopted and enforce a variety of other consumer protection laws and regulations designed to ensure disclosure, fairness, and competitive equity.

State insurance regulators actively supervise all aspects of the business of insurance, including review and regulation of solvency and financial condition to ensure against market failure. Public interest objectives are achieved through review of policy terms and market conduct examinations to ensure effective and appropriate provision of insurance coverages. Regulators also monitor insurers, agents, and brokers to prevent and punish activities prohibited by state antitrust and unfair trade practices laws and take appropriate enforcement action, where appropriate. Specifically, insurers are subject to systematic, comprehensive review of all the facets of their operation in its business dealings with customers, consumers, and claimants. The examination process allows regulators to monitor compliance with state insurance laws and regulations, ensure fair treatment of consumers, provide for consistent application of the insurance laws, educate insurers on the interpretation and application of insurance laws, and deter bad practices. Comprehensive examinations generally cover seven areas of investigation, including insurance company operations and management, complaint handling, marketing and sales, producer licensing, policyholder services, underwriting and rating, and claim practices.

State insurance regulators also interact directly with consumers. As an example, nationwide state insurance regulators handle approximately 3.7 million consumer inquiries and complaints in a single year. Inquiries range from general insurance information, to content of policies, to the treatment of consumers by insurance companies and agents. Most of those consumer needs were resolved successfully and with little or no cost to the consumer. Recent examples underscore the ability of state regulators to respond to consumer protection issues. In response to allegations of improper producer compensation activities – uncovered, investigated and adjudicated by state regulator and law enforcement officials – state regulators moved swiftly to develop model disclosures, coordinate consistent regulatory actions and settlement agreements, improve consumer protections and, in certain instances, bring civil and criminal prosecutions.

1.5: What role should the States have in the regulation of financial institutions? Is there a difference in the appropriate role of the States depending on financial system protection or consumer and investor protection aspects of regulation?

As previously noted Congress specifically and consciously delegated the regulation of the business of insurance to the states. Insurance, particularly property and casualty, is primarily local in nature. The high degree of interaction between state

law, geographic conditions, demography and other factors necessitate a role for the states in the regulation of property and casualty insurance.

1.6: Would the U.S. economy and capital market competitiveness be better served by pursuing greater global regulatory convergence?

Cooperation and coordination among the various global financial services regulatory bodies is a positive development. However, such cooperation and coordination should not come at the cost of abrogation of regulatory authority to foreign jurisdictions or quasi-governmental bodies.

Movement of capital which is intended for risk or insurance flows generally freely at the 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 EU and U.S. provide a sound basis for further collaborative efforts.

U.S. insurance regulators through the National Association of Insurance Commissioners participate in the International Association of Insurance Supervisors. 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, reinsurance regulation and other issues of regulation of the business of insurance.

Insurance

2.2.1 What are the costs and benefits of state-based regulation of the insurance industry?

State insurance regulation has proven to be adaptable, accessible, and relatively efficient, with rare insolvencies and no taxpayer bailouts. However, state regulation sometimes can be slow to act and can be inconsistent from state-to-state. Furthermore, many states still have unnecessary rate regulation that often results in fewer choices and higher rates for consumers.

Insurance – particularly property and casualty insurance – is local in nature. State and local laws determine coverage and other policy terms. Reparation laws affect claims. Local accident and theft rates impact pricing. Climate – hurricanes, earthquakes, etc. – differs significantly from state to state.

One advantage possessed by state governments is the ability to adapt to the unique issues faced by each state. State regulators and legislators are in the best position to consider and respond to marketplace concerns ranging from risks related to weather, specific economic conditions, medical costs, building codes, and consumer preferences. In addition, state regulation is able to respond and adapt to inconsistencies created by various state contract, tort and reparation laws. Since each state has its own unique tort laws that significantly affect insurance, insurers would still have to tailor their products to accommodate each state's tort laws regardless of the regulatory framework under which it is chartered or regulated. Our system of contract law is deeply developed, and with respect to insurance policies is based on more than a century of policy interpretations by state courts. Our tort system, which governs many of the types of contingencies at the heart of insurance claims, particularly those covered by liability insurance, is also deeply based in state laws that affect insurance risk including, for example, the law of defamation, professional malpractice, premises liability, state corporation law and products liability law.

With the ability to respond to unique local issues, the individual states serve as a laboratory for experimentation and a launch pad for reform. State-based regulators have the ability to develop expertise on issues particularly relevant to their state. Insurance consumers directly benefit from a state regulators' familiarity with the unique circumstances of their state. Over time, state insurance departments accumulate a level of "institutional knowledge" that has helped regulators develop consumer assistance programs tailored to local needs and concerns. State regulators have a strong incentive to deal fairly and responsibly with consumers. Eleven state insurance departments are headed by commissioners who are directly elected by their states' voters; the others serve at the pleasure of governors who also must answer to voters. A federal regulator, by contrast, would be far less accountable to consumers in particular states, and would thus have less motivation to be responsive to their needs.

Recent reports and surveys have been published citing costs of compliance with state insurance regulation and attempting to quantify savings from the use of federal regulators. While regulatory costs related to multiple jurisdictions are not insignificant, the greatest costs are imposed by the regulatory structure itself in the form of price and form regulation and extensive examinations, rather than the level or location of the regulator. There are various options for achieving uniformity and regulatory relief – model regulations and laws; domiciliary deference; interstate compacts – that should result in significant cost savings for both insurer and regulator. Moving to open competitive markets would result in further reductions of unnecessary costs and market inefficiencies.

2.2.2: What are the key federal interests for establishing a presence or greater involvement in insurance regulation? What regulatory structure would best achieve these goals/interests?

In recent years the federal government has taken a vital and necessary role in various issues impacting insurance regulation.

In 1968, Congress created the National Flood Insurance Program (NFIP) to partner with private insurers to write and administer the program to offer coverage to America's homeowners in the event of flood. NAMIC supports the continuation of the NFIP and urges reform of the program to include more support for mitigation, mapping, actuarial rates for second homes, and stronger penalties for financial institutions that do not ensure that their customers maintain their flood policies.

In the wake of the tragic events of Sept. 11, 2001, Congress moved to develop a public/private partnership with insurers to provide coverage for losses from acts of terrorism. Terrorism is fundamentally an uninsurable risk, due to the inability of insurers to predict when events will occur and because of the potentially catastrophic costs of an attack and a public/private partnership is necessary and appropriate. To be effective, a permanent terrorism program must allocate the costs of terrorism events between the private and public sector in a way that maximizes private sector involvement while assuring that private insurers can continue to meet their obligations across all economic sectors and insurance product lines after a terrorism event. The goal of public policymakers should be to allow the private sector to take on as much of the risk as possible by devising a plan that will enable insurers and reinsurers to provide coverage at affordable prices so that it will be purchased by businesses and commercial property owners. To achieve these goals and ensure maximum insurer participation, deductibles and copays must remain at current levels or below and the event trigger should be lowered from $100 million to $50 million.

In addition, Congress is currently debating proposals to facilitate planning for and response to natural catastrophe losses. There is a legitimate and appropriate role for federal involvement, including facilitating accumulation of tax-deferred reserves for catastrophe losses, and encouraging appropriate land use and building code standards. Specifically, NAMIC believes there is an appropriate federal role in providing financial incentives for those states that enact strong state-wide building codes, amending the federal tax code to allow insurers to set aside a portion of premium income in tax-exempt policyholder disaster protection funds and individual homeowners to create tax-free catastrophic savings accounts similar to health savings accounts which could be used to pay hurricane deductibles and costs associated with retrofitting properties.

Business or general commerce issues, such as electronic signatures and credit report and privacy standards, affecting insurers also call for a federal interest. For

example, the Fair Credit Reporting Act (FCRA) governs the use of credit reports, including regulating prescreening and firm offers of credit or insurance and the GLBA establishes requirements for privacy notices. Insurers have also encouraged Congress to act to establish consistent national standards related to credit freezes and social security number use and preempt inconsistent state laws. Such laws are directly related to business practices and procedures distinct from "the business of insurance" and are appropriate for national standards.

In addition, an area that could be explored is a role for Congress in achieving targeted reforms that the states have not yet acted on through a "targeted federal tools" approach. And, indeed, the House already has taken a positive step in that regard by passing H.R. 1065, which streamlines regulation for nonadmitted insurance and reinsurance carriers. If Congress pursues targeted reforms two additional areas for consideration include:

1. Prohibiting states from limiting property-casualty insurers' ability to set prices for insurance products, except where the insurance commissioner can provide credible evidence that a rate would be inadequate to protect against insolvency; and,
2. Prohibiting states from limiting or restricting the use of underwriting variables and techniques, except where the insurance commissioner can provide credible evidence that a challenged variable or technique bears no relationship to the risk of future loss.

It is not necessary to replace the current functional regulatory framework to successfully achieve federal interests in these areas. However, greater coordination between functional regulators at the federal and state level is essential. A recent example highlights this need. The interagency proposal for a model privacy form under GLBA was developed by the functional federal regulators with little interaction or coordination with state insurance regulators. The resulting draft model form published for comment as a notice of proposed rulemaking on March 29, 2007, is inadequate to meet the specific needs of insurers. Such issues could be mitigated or avoided with greater inclusion of state regulators as part of interagency deliberations without changes to the existing regulatory structure.

2.2.3: Should the States continue to have a role (or the sole role) in insurance regulation? Insurance regulation is already somewhat bifurcated between retail and wholesale companies. Does the current structure work? How could that structure be improved?

As previously noted, the states must continue to have the primary role in the regulation of insurance. NAMIC believes that a reformed state-based system offers

the greatest chance to achieve the regulatory and market reforms necessary for the modern marketplace while addressing local conditions and needs.

State insurance regulation in recent years received justified criticism for overregulation of price and forms, lack of uniformity, and protracted speed to market issues. While much more reform is still needed, the states have not been oblivious to the criticism that they need to change with the times, and they have made some significant progress in addressing antiquated rules such as those involving price controls and company licensing restrictions. Specifically:

- Ten states have adopted flex-band rating systems for property-casualty products to replace the rigid system of price controls.
- Fifteen states have adopted the more flexible use-and-file system.
- Twenty-six states have established no filing requirements, mostly for large commercial risks.
- Only 16 states still require statutory prior approval. Several of these states, however, are among the largest in the country, accounting for 40.8 percent of the total auto insurance market and 41.4 percent of the total homeowners insurance market nationwide.
- With respect to insurer licensing, the Uniform Certificate of Authority Application (UCAA) is now used in all insurance jurisdictions.
- A system of electronic filing has been implemented by most states and has streamlined the process by which rates and forms are filed by companies.
- Thirty states have now adopted the Life Insurance Interstate Compact, which allows the compact to now function and serve as a single point of filing for life insurance products.
- The National Conference of Insurance Legislators (NCOIL), the National Conference of State Legislatures (NCSL) and the American Legislative Exchange Council (ALEC) have all endorsed competition as the best regulator of rates. NCOIL has adopted a significant model law that would create a use and file system for personal lines and an informational filing system for commercial lines.
- NCOIL has also adopted a Market Conduct Model Law that will bring significant reform to that area of state regulation.

Additional reforms still must be made including elimination of price regulation, streamlining the agent and company licensing procedures, modernizing the market conduct examination process, including effective due process protections for insurers, and increasing speed to market for products.

NAMIC also supports pending legislation – H.R. 1065, the Nonadmitted and Reinsurance Reform Act of 2007 - to reform the surplus lines market. The legislation, recently approved by the House of Representatives, would create a uniform system for taxing and regulating surplus lines or nonadmitted insurance by

establishing national standards for how states may regulate, collect, and allocate taxes. As approved by the House, the legislation establishes national standards for modernizing the insurance regulatory system, while leaving the day-to-day control at the state level.

The legislation gives the home state regulator of the insurer primary oversight of multistate surplus lines risk and responsibility for allocating any taxes collected on the coverage to the other involved states. It also makes it easier for sophisticated purchasers to access the surplus lines market. NAMIC believes that H.R. 1065 is an example of how the current structure can be utilized to achieve simplification and uniformity.

2.2.4: States have taken an active role in some aspects of the insurance marketplace (e.g., workers' compensation and residual markets for hard to place risks) for various policy reasons. Are these policy reasons still valid? Are these necessarily met through state (as opposed to federal) regulation?

States have developed a variety of mechanisms to address issues within their individual states. [2] States have a vested interest in ensuring adequate insurance for drivers on their roads and have created residual mechanisms to ensure coverage to drivers who otherwise may be unable to qualify for insurance in the traditional market. Similarly, states have established such mechanisms for property and business insurance. Residual market mechanisms vary state-to-state based on local needs and participation rates fluctuate as laws change, market conditions vary or other underwriting factors change. A number of considerations may factor into the need to seek coverage from the residual market. Certain factors, such as poor claims records or inadequate safety records, may be influenced by the individual or company. Other factors such as the nature of the business or profession, or the specific property location where the risk of theft, vandalism or severe storm damage is substantial may be beyond the control of the policyholder.

States maintain a vital and vested interest in ensuring that adequate levels of protection are available. In many states, the insurance commissioner has been given standby authority to set up a residual mechanism whenever marketplace conditions for any type of insurance require such a move.

Residual, or shared or involuntary markets, by their nature are rarely self-sufficient and costs are typically passed on to all insurance consumers within that individual state. Residual property plans have grown substantially in recent years. According to the Insurance Information Institute, by year-end 2006, total exposure to loss in state-run property insurers had reached more than $600 billion and the number of policyholders insured was in excess of two million. In contrast participation in state

[2] Mechanisms include assigned risk plans, joint underwriting associations, reinsurance facilities, state funds, market assistance plans, FAIR plans, assigned risk plans and pools.

automobile residual markets declined to 1.5 percent in the available data, and in most jurisdictions the percentage is well under one percent. Similar positive trends are evidenced in the workers' compensation market. Estimated residual market premiums in 2006 for the pools serviced by the National Council on Compensation Insurance declined to $1.2 billion, a drop of about 16 percent from the previous year, when the premium totaled $1.4 billion. The residual market's share of the total workers compensation market also decreased, falling to an estimated 9.5 percent of the total in the states for which NCCI collects data, compared with 12 percent for 2005.

The type and scope of the mechanism is dependent on state and local conditions and the variety of mechanisms provide state legislators and regulators with the ability to tailor the program to their individual needs. Attempts to establish residual markets on a national level could lead to distortions and cross subsidizations.

Conclusion

NAMIC fully supports the Department's goal to simplify and modernize the nation's financial regulatory process. We look forward to working with the Department on development of the blueprint for regulatory reform and to improve and enhance the state-based insurance system for our nation's insurers and policyholders.

Specific questions on the comments may be directed either to me or Carl Parks at 202-628-1558

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Sincerely,

Charles M. Chamness
President and CEO
National Association of Mutual Insurance Companies
122 C Street, N.W.
Suite 540
Washington, D.C. 20001