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ROLL NUMBER

DESCRIPTION

1329

2005 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1329

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HB1329

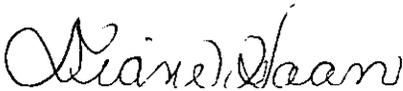
House Industry, Business and Labor Committee

Conference Committee

Hearing Date 1-18-05

Tape Number	Side A	Side B	Meter #
2	x		44.9 ---- end
		x	0 ---- 46.0

Committee Clerk Signature



Minutes:

Chairman Keiser: Opened the hearing on HB1329. The bill I bring to you today is revolutionary change in the way that we'd implement insurance regulations in the State of ND. We'll have people here who will explain each section. This bill does 2 things; it's a file & use form in which an insurance company that wants to & has been accepted to do business in the state, comes in & file their proposal with the Insurance Commissioner & the Dept & is approved to market their product. The Commissioner reviews it & if there are problems with it, takes action. This deals with modernization of the insurance industry. The Smart Act is out there & it's up to states to look at whether or not they want to modernize. There's a file & use, a use & file, where states would approve (you could use it & then file it), also form modernization is another issue. Illinois was the 1st State to go file & use & it's been very beneficial, but it's a very different state. It may or may not be appropriate from a policy perspective for a small rural state, versus a large urban state. Some states have moved to file & use & have had very positive

responses from it. The insurance companies like it, in a very hard market they're looking for opportunities that make their doing business in your market place more business friendly. File & use is business friendly, the question we have as policy makers, is it customer friendly. We want to make sure we're covering both sides. Any questions?

Pat Ward, Representing Public Casualty Insurers Assoc of America: (0.2 Side B) appeared in support of HB1329. (See attached testimony). Any questions?

Rep. Ekstrom: (6.9) In regards to prior approval for modifying any rate, which way do they usually go?

Ward: Depends on market conditions, but generally rates go up.

Rep. Ekstrom: (7.4) By definition, ND is not a competitive market because of it's size & the geographic distribution of people. Would you say that we rank in the same ballpark as Ill. in competition?

Ward: There are differences between states because of population, but I believe ND is a competitive market, we already have some of lowest rates in the nation. South Carolina has had tremendous success & is similar to ND.

Rep. Ekstrom: (8.43) This is wonderful in theory, I'd like to a like state that has a similar market. What we've been seeing is the reverse trend of insurers leaving the market, not coming in. I don't see how removing barriers will help us.

Ward: South Dakota is a like state, & they just did it. The same kind arguments were raised in SC & Ill & they tried it the success was overwhelming. States that are heavily into the regulation insurance like Mass & NJ tend to have the highest rates. We should trust the market, give it a try & change it back in 2 yrs if it's not working.

Rep. Ekstrom: Regarding modernization, one of things we've done, is to continually modernize the way insurance is regulated by the Insurance Commissioner, based on the National Assoc of Insurance Commissioners Model. How does this fit into any national assoc?

Ward: This is not a National Assoc of Insurance Commissioners Model, but it is a National Conference of Insurance Legislators Model.

Rep Kasper: (10.7) It's widely known in ND & nationwide that Commissioner Poolman runs responsive to the insurance industry's needs & consumers of our state. Have you heard of any complaints from insurance companies about the ND Insurance Dept lack of timely approval?

Ward: No

Rep Kasper: How does this change the circumstances in ND if there's not an existing problem?

Ward: One example would be rate increases that went into effect after the hail storms in ND, many home owners saw their premiums spike, in some cases up to 25%. Had this kind of a system been in place those rates could have been gradually increased so they wouldn't they wouldn't have been hit with a huge increase. Also, other companies that aren't doing business in ND now, when they look at the market to say, "Oh, ND is a using file or file use state, it's more progressive, it's a market where we want to business."

Rep Kasper: (12.5) How many insurance companies are members of NAMIC & how many are currently licensed in the State of North Dakota?

Ward: 1,350 member companies. In ND, NAMIC members (including 16 domiciled companies) underwrite 36.5 percent of the direct written premium in the state. NAMIC membership includes 4 of the 7 largest property/casualty carriers, every size regional & national property/casualty insurer & hundreds of farm mutual insurance companies.

Rep Kasper: How many numbers are licensed?

Ward: I don't know, but it would be quite a few.

Rep Kasper: Have your NAMIC companies flatly told you that if you change ND statute, we'll be there?

Ward: I don't know that for a fact. To make the record clear, I do not represent NAMIC.

Rep Dosch: (14.4) You indicate that this file system will only be used for personal lines? Can you explain why not commercial?

Ward: The theory is that the same kind of approvals aren't required for commercial policy holders because they're more sophisticated. They spend more money on premiums so they tend to be more careful about they spend their premiums, so the feeling is that regulation isn't needed as needed.

Dennis Prinbivile, President of Dakota Fire Insurance Company in Bismarck: We are a member of NAMIC & we support this bill. Our branch ofc in Bismarck operates in a 4 state area (North Dakota, South Dakota, Montana & Idaho) & we handle about \$68 M in written premium as of yr end in 2004. In the other states we already have this type of bill, they are under file & use, or use & file system & it works just fine, we haven't had any problems. There are safeguards in the bill that grants the Commissioner the ability to impose prior approval in case something does happen in our market. Other states look at state regulation as an obstacle for them & unless we do something, we're going to have federal legislation.

Rep Kasper: (16.3) If we went to this filing system, how much time & cost would you estimate that it would save your company in the State of ND?

Prinbiville: I don't think I can give you an answer on that. Our biggest delay is our own data processing department.

Rep Kasper: Is it the fear of federal regulation, more than the cost, that makes you want to get this through?

Prinbiville: Yes, that would be my largest concern.

Kent Olson, Exec Director of the Professional Ins Agents of ND: appeared in support of HB1329. Revolutionary change is the driving force behind this bill. Our first concern is on P. 7, L. 22 & 23; why isn't commercial included (for rating systems)? Another concern is on P.7, L. 24; is the 30 day window too narrow? The next item is the definition of competitive market & non competitive market; are we going to take anything away from the competitive market definition, from the Insurance Department. How we determine this; (33.4) on P. 8, L. 24, it says presumed unless Commissioner determines it's not; P.11, Sect 6, L. 18 & 19 is a red flag for us. We're saying the Commissioner can't disapprove the rate unless they're inadequate, which leads to our next question, so what about solvency (keep an eye on solvency)? We interpret that the Competitive market will apply to hail insurance. One thing to be careful of with competition, is the soft market, or low premiums; they're great for awhile; they need to be monitored. In summary, we basically support the bill, we support anything that makes ease of market speed the market competition; we'd oppose any federal intervention.

Chair Keiser: (33.4) On P. 8, L. 24-26 ... it surprises me that you're coming out with your background & raising the questions that you did. Isn't it pretty much the language that we use for the Commissioner to determine that something goes into the surplus line?

Olson: The Commissioner does do that now; the problem that we see is the take away from his office on P. 11, L 18; it says he may not disapprove a rate in a competitive market unless there's underpricing inadequacy.

Chair Keiser: So he can't disapprove it if it's not underpriced or unfairly discriminatory. What the Commissioner's doing raises a major red flag, P. 8, L. 24-27, on something the Commissioner already does; now you come back & say he can't effect anything if it's in a competitive market, but didn't mention underpricing, that was the issue you raised. The Commissioner has full authority, with underpricing, to come back in & regulate.

Olson: The problem that we're looking at is the solvency issue if it is in a competitive market. Can he come back here & change those rates quickly, or does he have to wait for 1 yr? (The 1 yr deals with the noncompetitive side.)

Chair Keiser: The issues you say it doesn't address, I believe it does ... any opposition?

Rep Kasper: (26.2) Commissioner Poolman, I'm totally against federal regulation & intervention in anyway in the insurance market. Would this bill solve any problems as far as what we need to do, as a state & other states, to keep the federal government out of it?

Jim Poolman, ND Insurance Commissioner: (27.6) Besides legislation that is being introduced in several states related to changing the (*?can't understand*) there's several initiatives going, several of which we have done (in the ND Insurance Dept) to make the market more competitive & modernize the system that we have done business with & have changed under my administration. I'd like to focus on that & then answer your questions. At one time the industry had a legitimate gripe, filings were taking too long & couldn't potentially get a rate ?into factor. Very shortly after I got there we undertook an initiative to review all of the "desk

drawer rule"; that is a regulation that's been ?republished, that sits in someone's desk drawer that the previous commissioners (both Republican & Democrat) came up & said, "we think we have the legislative authority to require an insurance company to do this, let's require them to do this."

After reviewing everyone of those "desk drawer rules", we found we didn't have legislative authority for many of them. We've come down in the last 2 sessions from requesting certificate of authority on some of those issues or just can several of the regulations that we determined never provided any sort of legitimate consumer protection for ND consumers. We've set performance initiatives for our staff that review filings within the dept & we've also updated the electronic technology in our dept to be able to accept rate & form filings electronically. In 2003 we received 12% property & casualty filing electronically & 2004 to 28% . The electronic filings are given preferential treatment because they're easier to do. Every rate & form filing (on average) that come into our dept are approved within 17-25 days so we think we've made enormous strides in that regard to get rate & policy approval out into the market place. Previous to me getting there, we never analyzed the market place; the folks in the property & casualty division, at my request, do an analysis of our market place every yr. The frequent weather related disasters that we've had has not been helpful to the market place in ND. I'm not opposed to this bill but have concerns about moving away from a prior approval system in a market place that has been traditionally been very hard over the past several yrs because of the downturn in the general economy & the number of weather related disasters we've had in ND. In 2001, the statewide average loss ratio in ND was 297%; companies, on average, in ND pd out \$3.00 for every \$1.00 they took out in premium. What about the company that wants to come in & get all of those dollars back in 1 yr that they've pd out in previous yrs? Under a prior approval system

we have the ability to determine if that's inadequate, accepted or unfairly discriminatory. Under the past 3 yrs, the statewide average loss ratio in homeowners insurance has been about 30-35% (35 cents pd out on every \$1.00) due to better weather. We want to be able to provide stability in rates. Congress is considering intervention that's specifically driven the life insurance industry who would eventually like to have national federal charter.

Rep Kasper: (35.2) Under this bill, the company uses & files & then you're notified of the rate & if you disagree with the rate, is your power taken away or do you have the same opportunity to sit down with that company & discuss it?

Poolman: We work & communicate with companies now & it will probably work the same way in the stand point of having a relationship with companies that are in our market place & we feel they have an inadequate rate (very few are) but the only way we have the leverage to work with companies on the rate is if it's inadequate or unfairly discriminatory.

Rep Kasper: (37.5) This is a huge bill. What areas of the bill are you concerned about & are there some modifications that need to be made to better serve consumers & the industry?

Poolman: Yes. Our concerns are the same as the chairman of the property & casualty. We want to provide the best market place for ND consumers. We'll be happy to look at the bill

Chair Keiser: (39.6) In terms of federalization's, clearly the life insurance industry has more potential for moving towards federal legislation; however, based on your experience with NAIC, are there not major P&P companies which are lobbying for federalization?

Poolman: The reason they're lobbying for federalization is specifically as rate relief.. I don't feel it will get done. There are other issues that Congress is working on related to insurance regulation. One of the questions asked is "where is NAIC on some of this modernization stuff,

specifically related to rate relief & another is where do commercial lines fit in there?" The nation's regulators feel the same way as the folks that sit up here & advocated on the commercial line's side that they are more sophisticated consumers & don't necessarily need rate & policy regulation.

Chair Keiser: (42.0) The Commissioner & I can have a discussion later, but his position & my position are very different.

Rep Thorpe: (44.0) Without this bill, presently what you do in regulation is proactive; in this bill, do you see you'd be reactive?

Poolman: (45.6) We approve every rate & policy that's put out into the market place. Under this bill, we would not do that, we would not have regulation up front, it would be after those rates would be in the market place.

Chairman Keiser: (45.6) Any further testimony, seeing none we'll close the hearing on HB1329.

PROPOSED AMENDMENT TO HOUSE BILL NO. 1329

Kaiser

Page 2, line 23, after "means" insert "any financial guaranty insurance policyholder, or"

Page 15, line 22, after the first "to" insert "any financial guaranty insurance policyholder,
or"

Page 15, line 23, after "chapter" insert ", and a financial guaranty insurance policy is not
subject to any of the following provisions"

Date: 2-1-05

Roll Call Vote #: 1

2005 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1329

House

INDUSTRY, BUSINESS AND LABOR

Committee

Check here for Conference Committee

Legislative Council Amendment Number

Action Taken

Adopt Amendments by Keiser

Motion Made By

Rep. Ruby

Seconded By

Rep. Dosch

Representatives	Yes	No	Representatives	Yes	No
G. Keiser-Chairman	X		Rep. B. Amerman	X	
N. Johnson-Vice Chairman	X		Rep. T. Boe	X	
Rep. D. Clark	X		Rep. M. Ekstrom	A	A
Rep. D. Dietrich	X		Rep. E. Thorpe	V	
Rep. M. Dosch	X				
Rep. G. Froseth	X				
Rep. J. Kasper	X				
Rep. D. Nottestad	X				
Rep. D. Ruby	X				
Rep. D. Vigesaa	X				

Total (Yes)

13

No

0

Absent

(1) Rep. Ekstrom

Floor Assignment

Rep. Kasper

If the vote is on an amendment, briefly indicate intent:

Date: 2-1-05
Roll Call Vote #: 2

2005 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1329

House **INDUSTRY, BUSINESS AND LABOR** Committee

Check here for Conference Committee

Legislative Council Amendment Number

Action Taken **Do Pass As Amended by Keiser**

Motion Made By **Rep. Nottestad** Seconded By **Rep. Ruby**

Representatives	Yes	No	Representatives	Yes	No
G. Keiser-Chairman	X		Rep. B. Amerman		X
N. Johnson-Vice Chairman	X		Rep. T. Boe	X	
Rep. D. Clark	X		Rep. M. Ekstrom	A	A
Rep. D. Dietrich	X		Rep. E. Thorpe		X
Rep. M. Dosch	X				
Rep. G. Froseth	X				
Rep. J. Kasper	X				
Rep. D. Nottestad	X				
Rep. D. Ruby	X				
Rep. D. Vigasaa	X				

Total (Yes) **11** No **2**

Absent **(1) Rep. EKStrom**

Floor Assignment **Rep. Kasper**

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1329: Industry, Business and Labor Committee (Rep. Keiser, Chairman)
recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends
DO PASS (11 YEAS, 2 NAYS, 1 ABSENT AND NOT VOTING). HB 1329 was placed
on the Sixth order on the calendar.

Page 2, line 23, after "means" insert "a financial guaranty insurance policyholder or"

Page 15, line 22, after the first "to" insert "a financial guaranty insurance policyholder or"

Page 15, line 23, after the period insert "A financial guaranty insurance policy is not subject to
the provisions of this section"

Renumber accordingly

2005 TESTIMONY

HB 1329

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January 17, 2005

The Honorable George J. Keiser
Chairman, House Industry, Business and Labor Committee
North Dakota House of Representatives
422 Toronto Street
Bismarck, ND 58503-0276

Dear Chairman Keiser:

Thank you for this opportunity to express support for HB 1329, which enacts and amends sections of the North Dakota Century Code relating to the regulation of fire, property, and casualty insurance rate and rate filings. NAMIC is a full-service international trade association with more than 1,350 member companies underwriting 41 percent (\$170 billion) of the property/casualty insurance premium in the United States. In North Dakota, NAMIC members (including 16 domiciled companies) underwrite 36.5 percent (\$433 million) of the direct written premium in the state. NAMIC membership includes four of the seven largest property/casualty carriers, every size regional and national property/casualty insurer and hundreds of farm mutual insurance companies.

NAMIC member companies strongly support a "modernized" system of state insurance regulation and believe that the rate and rate filing changes called for in HB 1329 will be of great benefit to North Dakota insurance markets. Furthermore, enactment of HB 1329 would send a strong message to Congress that states can improve and modernize the state system of insurance regulation. NAMIC supports HB 1329, which is based substantially on the National Conference of Insurance Legislators (NCOIL) Property/Casualty Insurance Modernization Act, because it calls for the elimination of prior approval of rate and rate filing standards for fire, property, casualty and commercial lines of insurance. Following enactment, for personal lines, the bill requires all rates and supplementary rate information to be filed with the commissioner no later than thirty days before the effective date of the rate. After August 1, 2007, assuming the commissioner has filed a report with the legislative council, insurers will be required to file all personal lines rate and supplementary rate information with the commissioner no later than thirty days after the effective date of the rate. For commercial lines of insurance, rates need not be filed. The bill also grants authority to the commissioner to determine that a reasonable degree of competition does not exist within a market and provides authority to impose prior approval rate and rate filing standards on that market.

NAMIC's number one public policy priority is the preservation of state regulation of insurance through the adoption of regulatory "modernization" laws. Adoption of regulatory "modernization" laws benefits consumers with respect to price and availability. The elements of a modernized system of regulation include: a use-and-file system for personal lines; a no-file system for commercial lines; continued regulator authority to monitor market competition; and due process for consumers and the insurance industry. NAMIC is also a strong proponent of reformed market conduct and financial solvency regulation to create a safety net for consumers

against haphazard business practices. Our ultimate goal is to achieve a proper balance of regulatory focus. To that end, we are, as you know, working in partnership with the National Conference of Insurance Legislators (NCOIL), the National Conference of State Legislators (NCSL) and our other industry colleagues to secure passage of regulatory "modernization" laws in as many states as possible.

Insurance is an industry where less government control has been tested and found to be successful. For example, in 1969, the State of Illinois repealed prior approval and adopted a use-and-file system of rate regulation for personal lines of insurance, a system that is still in effect today. Several signs demonstrate this system works well and benefits consumers. Illinois consumers enjoy stable rates, ranking in the middle of all states in average expenditures for insurance. Also, Illinois has a low residual market indicating affordability and availability of insurance products. As a second example, consider the State of South Carolina. In 1996 only 78 insurers offered auto insurance policies in the state and 40 percent of all insured drivers were in the assigned risk pool. With the elimination of prior approval in 1999, 105 new companies have entered the market, rates are lower and residual market participants, once numbering over one million, have declined to 58,000.

Progress does not stop with Illinois and South Carolina. Over the past two years, nine states have adopted some form of regulatory modernization. In 2003, modernizing legislation was adopted in Nebraska (commercial lines), New Hampshire (commercial lines), New Jersey (auto) and Louisiana (personal lines). In 2004, modernizing legislation was adopted in Massachusetts (commercial), Oklahoma (personal lines), Rhode Island (personal lines), South Carolina (homeowners) and South Dakota (personal and commercial lines). Currently, 18 states observe prior approval, 23 states observe file-and-use and 9 states observe use-and-file systems of rate regulation.

Thank you for your leadership on this critical public policy issue and thank you for this opportunity to express support for HB 1329.

If you have questions or need further information, please feel free to contact me at (317) 875-5250 or via e-mail at jthesing@namic.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Joe Thesing". The signature is fluid and cursive, with a large initial "J" and "T".

Joe Thesing
State Affairs Manager
Central Region

TESTIMONY OF PAT WARD HB 1329

Chairman Keiser and members of the House-IBL Committee, I represent PCI and support HB 1329. A majority of North Dakota property and casualty insurers belong to the Property and Casualty Insurers Association of America. Together with NAMIC, we asked Representative Keiser to introduce this bill.

BACKGROUND

Over the past few years, most sectors of the financial services industry have undergone regulatory reform to facilitate speed to market for innovative new products to benefit consumers. Regulatory modernization has accelerated competition among businesses, while at the same time reducing prices and expanding options, service, and quality for consumers. Yet, the insurance industry stands out as one of the most heavily regulated sectors of our economy with respect to price and product controls. House Bill 1329 is based on a model bill proposed by the National Conference of Insurance Legislators (NCOIL) which will modernize North Dakota's system of insurance regulation over rate filing.

A number of recent developments have accelerated the need for insurance regulatory reform to facilitate speed to market for property-casualty insurance. History has shown that states with less regulatory control have more competition which lowers rates for consumers. With the cost of insurance premiums rising in North Dakota, HB 1329 will allow for more competition in an open, competitive market, thus bringing more options and lower prices to North Dakota's consumers. In addition, the internet and other e-commerce are helping expand the information available to North Dakota's insurance consumers. The

insurance buying consumers of North Dakota are more educated and informed than ever before, and thus need to have more availability in products and rates to suit their individual needs.

TRANSITION TO A USE AND FILE SYSTEM

HB 1329 will modernize North Dakota's current rate regulation system. Under North Dakota's current law, insurers are required to get prior approval before modifying any rate. There are a number of problems with the prior approval system. Prior approval increases costs for insurers. Insurers face increased costs with the administration and compliance with the complicated rate filing and approval process. Unfortunately, it is the consumer who ultimately bears these administrative costs in the form of higher premiums. The prior approval process also creates delays in adjusting rates to consumer market trends. Historically, the regulatory delay and costs involved with prior approval tend to produce fewer, but significantly larger rate changes and greater swings in the availability of coverage. HB 1329 is intended to reduce the "sticker shock" consumers experience because of these large changes in price and availability of insurance coverage.

The main portion of HB 1329 is the modernization of rate filing from prior approval to a use and file system of insurance rate filing. The bill once passed will create a file and use system, which will eventually transition into a use and file system on August 1, 2007. Under a use and file system, the personal lines insurer will still file its rates and rules with the commissioner within thirty days after the rate becomes effective. The use and file system will only be used for

personal lines in a competitive insurance market, which is determined by the State's insurance commissioner. Under HB 1329, commercial insurance rates do not have to be ceding in a competitive market.

The nine states which have already adopted this use and file system have experienced very positive results, including more insurers competing for business and lower insurance prices. Twenty-three states have file and use, and 18 are still prior approval, but bills like this are being introduced in some of these other states as well. The use and file system has proven that when insurers are allowed to compete aggressively, consumers will benefit. The consumer should realize savings in insurance costs as the market becomes more efficient, competitive, and the costs of unnecessary regulation are squeezed out of the market. The states which have adopted the use and file system have also found that it produced more product options for consumers.

CONSUMER PROTECTION

As Legislators, one of your primary concerns is to protect North Dakota's consumers. What is important to note with HB 1329 is that every insurer will still be required to file all personal line rates it intends to use in North Dakota, the same as under the prior approval system. The Commissioner will still maintain regulatory control over every rate proposed in North Dakota. Under this system, the Commissioner still has the power to disapprove rates. HB 1329 allows the Commissioner to make a determination whether the North Dakota insurance market is competitive or non-competitive. In a competitive market, there are less rate restrictions, and the use and file system will be implemented. However, if

the Commissioner determines that a market is non-competitive, North Dakota's consumers will be protected by requiring that rates be ceding with the commissioner before they are implemented.

We have a system of state regulation of insurance. The federal congress has been increasingly more concerned about antiquated state systems and has threatened preemptive legislation if states do not conform and modernize.

When insurance regulation by states was originally adopted, there were two supporting rationales for regulating rates: 1) the possibility that insurers could engage in price wars that could lead to insolvencies; and 2) the possibility of collusion among insurers that might result in excessive prices and profits. The first concern is eliminated under HB 1329 by allowing the commissioner to disapprove any inadequate rate ceding by an insurer in both a competitive and non-competitive market. Secondly, under HB 1329, collusion amongst insurers to raise prices is highly unlikely when no entry barriers exist in the market because ease of potential entry effectively deters non-competitive behavior by insurers.

HB 1329 is a way to give substantial benefits to North Dakota's insurance consumers. Modernization to a competitive insurance market would eliminate unnecessary regulatory costs which would produce cost savings for insurers and lower prices for consumers. There is no economic support or logical rationale for continued price regulation in a competitively structured market. HB 1329 will increase competition amongst insurers, and competition creates a strong incentive for insurance companies to forecast costs accurately and price and

underwrite appropriately, which will ultimately lower prices and increase availability of insurance to North Dakota's consumers.

I urge a Do Pass on HB 132^a.

Insurance Market

Study: Is U.S. Federal Oversight the Answer?

As the U.S. Congress prepares to debate the matter and lobbyists from all sides swirl around the issue of state vs. federal regulation of the insurance industry, a newly released study by the Washington D.C. think tank Competitive Enterprise Institute provides one take on the pros and cons.

With insurance as the only sector of U.S. financial services left unregulated by the federal government, a change in oversight may be beneficial, but only if it is arranged thoughtfully and equitably, according to the author of the study, Catherine England, a professor at Marymount University School of Business Administration in Virginia.

"A well-designed system that includes a federal chartering option could benefit both insurance company owners and their policyholders. But federal chartering is not a panacea," England writes, adding that principles such as consumer education, state-based guaranty systems and oversight by the U.S. Department of the Treasury must be considered in order to make the system work.

While in the past the insurance industry has joined state regulators in opposing a federal role in regulating insurance firms and markets, England notes, industry opposition to federal oversight has begun to weaken as large, transitional insurance firms have expressed a growing interest in federal regulation.

Currently on the table are three forms of federal regulation, each with their own supporters and each with a different level of oversight:

--The State Modernization and Regulatory Transparency Act, authored by House Financial Services Committee Chairman Mike Oxley, R-Ohio and Richard Baker, R-La., chairman of that committee's Capital Markets Subcommittee, proposes broad changes to the way insurance is regulated. Among its 17 main provisions, the bill would end state-based regulation of rates, streamline agent and company licensing, and rein in states authority to conduct market-conduct examinations (BestWire, Oct. 12, 2004).

--The optional federal charter would allow insurers, as with the banking industry, to choose whether they would be regulated under the current state-based system or charter nationally.

--Also under consideration is an interstate compact through which the industry is working with the states to improve the state-based system of regulation in the

areas of speed to market, market-conduct examinations and producer licensing.

According to England, primary among the reasons for the industry's interest in the optional federal charter are the prospect of eliminating duplicative, state-by-state price and product regulation; creation of an alternative to state rate regulation that holds premiums below the cost of providing certain types of insurance coverage; stronger uniform consumer protections, and the provision of a more credible industry voice in the international trade market.

England explains that the advent of regulation of any sort in the insurance industry has been a long and gradual process, as has the growth of a competitive market. Change is inevitable as consumers now search the Internet for the best deal and the Main Street, mom-and-pop insurer has diversified, allowing acquisitions by national and global insurers with multibillion-dollar bottom lines.

"This landscape has changed. At the dawn of the 21st century, the market for financial services, including insurance, has become increasingly national, if not international, in scope. Geographic markets once deemed safe from competition now face an influx of new entrants," England said.

When it comes to the direction regulation oversight will take, industry opinion has been diverse.

Expected to move through the U.S. House and Senate early this year, the SMART Act is favored by a number of industry groups for its provisions meant to standardize certain aspects of insurance regulation across the United States. Those among its supporters are the American Insurance Association, the American Council of Life Insurers; the National Association of Insurance and Financial Advisors, the Council of Insurance Agents & Brokers and the American Bankers Association. (BestWire, Nov. 22, 2004)

One of its biggest supporters is past president of the National Association of Insurance Commissioners Ernst Csiszar, who is now president and chief executive officer of the Property Casualty Association of America.org.

"The fragmentation of insurance markets is neither efficient nor effective," he said. "When a company has to file over 350 versions of the same form in order to apply to sell one new product in 50 different jurisdictions -- and it then takes some states 18 months to approve that product -- clearly, we have a problem." (BestWire, Dec. 01, 2004)

Standing most staunchly on the side of the Interstate Insurance Product Regulation Compact has been its creators at the NAIC. The compact was legally created in 2004 when Colorado and Utah became the first two states to adopt legislation allowing it. The action was followed by the legislatures of West

Virginia, Virginia, Iowa, Maine, Hawaii, New Hampshire and Rhode Island.

Other states that began lining up in 2004 to consider introduction included Alabama, Connecticut, Illinois, Indiana, Kentucky, New Jersey, New York, Pennsylvania and Vermont.

Legislatures planning to introduce the compact this year include Arkansas, Indiana, Florida, Georgia, Kansas, Michigan, Montana, Nebraska, New Mexico, North Carolina, North Dakota, Texas and Washington.

Meanwhile, those lining up behind the optional federal charter include multiline life insurers, who say the regulatory model offers the ability to compete with banks.

"We strongly believe that those of us who operate nationally, those of us who operate in multiple lines, need to have a more efficient way to be regulated, and quite frankly, we think opting for federal regulation would benefit us," said J. Barry Griswell, chairman, president and chief executive officer of Principal Financial Group. Griswell also is chairman elect of the American Council of Life Insurers.

"I think over the next several years, it will probably emerge that we need to take one of these initiatives and turn it into something very, very actual, and I am hoping it will be the optional federal charter," Griswell said. (BestWire, Oct. 12, 2004)

England notes in her report that the primary argument in favor of maintaining the current state-based system lies in the nature of property-casualty insurance company liabilities.

"Unlike the liabilities of depository institutions, or even the liabilities of life insurance companies, the ultimate liabilities of a failed property/casualty company can be unpredictable," England said. "Think about the payouts facing insurers in the wake of a major natural disaster or in the aftermath of a terrorist attack. The failure of an insurance company providing extensive coverage to numerous policyholders in such circumstances could place a substantial burden on surviving members of the industry just when these companies are facing unexpectedly high claims of their own."

No matter what side one lines up behind, England said the debate about who oversees consumer protection promises to cause a political firestorm.

"Even if Congress passes legislation creating an optional federal insurance charter and providing for federal solvency regulation, many will argue that consumer protection regulation should begin with state regulators," England said. "Advocates of state-based consumer protection claim that local and state

government officials are in a better position to understand and meet the unique needs of individual states."

The AIA praised England's report, if only for highlighting the issue of federal oversight of the insurance industry.

The AIA has long supported regulatory reform to benefit consumers by "rationalizing and focusing the regulatory process" on core functions, such as market conduct and solvency, according to a statement issued by the group.

"We are encouraged that the topic of insurance regulatory reform continues to receive more and more attention on Capitol Hill and among opinion leaders across the country," said Leigh Ann Pusey, senior vice president of government relations for the AIA. "Thus, the report's title, 'The Devil is in the Details,' aptly describes the challenges ahead."

A copy of the England report may be viewed at (<http://cei.org/pdf/4358.pdf>) or at the Competitive Enterprise Institute Web site (www.cei.org).

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Federal Insurance Chartering: The Devil's in the Details

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Executive Summary

Of all the financial services firms in the United States, only insurance companies lack a federal regulator. While crises in the industry led to occasional calls for federal oversight, until recently, the insurance industry has joined state regulators in opposing a federal role in regulating insurance firms and markets.¹ Industry opposition to federal oversight has begun to weaken, however. Large, transnational insurance firms have expressed a growing interest in federal regulation.

There are several reasons for the industry's sudden interest in optional federal regulation. We will first examine insurers' support for—and their goals in seeking—an increased federal role. A brief look at the dual banking system, which allows banks to choose a federal or state charter, will help identify several of the key questions in designing a new regulatory structure. How policymakers answer these questions will determine whether a newly created "dual insurance" system will meet the goals of industry advocates.

Concern about efficient insurance regulation does not end with the executives and owners of the insurance companies. Policyholders and taxpayers also have an interest in creating an insurance regulatory system that encourages competition, innovation, and financial stability.² The goal of policymakers should be to create a regulatory structure that enhances rather than impedes the operational advantages of a competitive market. Such a regulatory system will serve the needs of customers while maintaining the financial health of the industry. This requires an "incentive compatible" system in which regulators, whether state or federal, balance the multi-faceted interests of insurance company owners and their customers, as well as taxpayers. Incentive compatibility requires unambiguous goals, clear lines of responsibility, and the attachment of costs to those responsible for regulatory failures. The savings and loan crisis of the 1980s stands as a stark and costly example of what can go wrong when policymakers and regulators can shift responsibility for bad policy decisions.³

This study neither supports nor opposes a federal oversight option for the insurance industry. A well-designed system that includes a federal chartering option could benefit both insurance company owners and their policyholders. It is important to recognize, however, that federal chartering is not a panacea. A poorly designed system could irreparably harm both insurance companies and their customers.

¹ See Scott E. Harrington, "Optional Federal Chartering of Property-Casualty Insurance Companies," (Downer's Grover, IL: Alliance of American Insurers, 2002), p. 31.

² Under the current guaranty system that protects policyholders of failed insurance companies, states' premium tax revenues are reduced in the wake of a failure. Therefore, an insurance company failure affects all taxpayers.

³ See Edward J. Kane, *The Gathering Crisis in Federal Deposit Insurance*, (Cambridge, MA: MIT Press, 1985) and *The S&L Insurance Mess: How Did it Happen?*, (Washington, D.C.: Urban Institute Press, 1989).