

**TESTIMONY OF  
THE CINCINNATI INSURANCE COMPANIES**

**BEFORE THE  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE  
AND GOVERNMENT-SPONSORED ENTERPRISES  
OF THE COMMITTEE ON FINANCIAL SERVICES  
UNITED STATES HOUSE OF REPRESENTATIVES**

**ON**

**“ADDITIONAL PERSPECTIVES ON THE NEED FOR  
INSURANCE REGULATORY REFORM”**

**OCTOBER 30, 2007**

**SCOTT A. GILLIAM  
ASSISTANT VICE PRESIDENT & GOVERNMENT RELATIONS OFFICER  
THE CINCINNATI INSURANCE COMPANIES**

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Introduction

Good afternoon Chairman Kanjorski, Ranking Member Pryce, and Members of the Subcommittee. My name is Scott Gilliam. I am Assistant Vice President and Government Relations Officer for The Cincinnati Insurance Companies, headquartered in Fairfield, Ohio, just north of Cincinnati.

Our group of companies market property and casualty insurance and life insurance in 34 states through an elite force of over 1,200 local independent insurance agencies. With over one million policies in force insuring businesses and families, our parent company, Cincinnati Financial, is the 23<sup>rd</sup> largest publicly traded property and casualty insurer based on 2006 revenues of \$4.5 billion

This is the second in a series of hearings by the Subcommittee on insurance regulatory matters and the need to improve insurance regulation. These hearings come at a time when the current system of insurance regulation is under scrutiny by insurance companies, regulators, agents, consumer groups, trade associations and Congress. A re-examination of the current system and the need for reform is necessary and healthy and I commend the Subcommittee for holding these hearings.

In today's hearing the witnesses have been asked to detail how the current regulatory structure affects consumers, insurance agents and brokers, and insurance companies and to identify which areas of insurance regulation require improvement and why. We begin with the premise that the states are in the best position to satisfy the public policy objectives of insurance regulation—to protect consumers, to assure the financial soundness and solvency of insurers, to promote competitive markets, and to enforce insurance laws. At the same time, we acknowledge that our current system of state-based insurance regulation is in need of reform and modernization.

In presenting our views on insurance regulatory reform this afternoon we have three goals: (1) identify the problems we see with the current system of state regulation; (2) emphasize our support for a continued system of state insurance regulation; and (3) suggest that public policy makers and interested parties may need to take a fresh approach to insurance regulation reform and consider alternatives to the current proposals on the table.

We would also suggest to the Subcommittee that our company may have a more independent voice in the debate over insurance regulatory reform since we are a major regional insurer but do not belong to any of the national insurance trade associations.

Insurance Is Local

We come to this debate on behalf of the hundreds of small and medium-sized insurers like ourselves who collectively insure millions of individuals and small businesses across this country who value their interaction with and connection to their state and local governments. That connection carries over into the business of insurance which, by its very nature, is uniquely local.

Consider the decision to purchase insurance, which is rooted in many local risk factors: Where does the policyholder reside? Is the insured property subject to earthquakes or hurricanes? How close is the nearest fire department? What is the policyholder's risk of civil liability under the laws of the state? What is the structure of the local hospital and physician marketplace?

Consider the types of occurrences for which individuals and business purchase insurance, all of which are uniquely local in nature: personal injuries, auto accidents, health problems and illnesses, lawsuits brought against individuals and businesses, property fires, employment-related injuries, loss of life, accidents at home, accidents in retail establishments, construction project defaults, and the list goes on and on.

Consider also the body of state and local laws that apply when insurable events occur, e.g., state tort law, contract law and social policy law.

It is in this context that the states have been established as the primary regulator of the business of insurance and it is for these reasons that the states should remain the primary regulator of the business of insurance since the activities and occurrences which necessitate insurance and its regulation are not uniform from place to place or state to state.

#### The Problem with State-Based Insurance Regulation: Needlessly Repetitive Regulation

There is great consensus that several areas of state-based insurance regulation are in need of reform. The areas which seem to attract the most complaints, and which are sometimes problematic for our company as we endeavor to market property casualty and life insurance products in 34 states, include product regulation, rate regulation, producer licensing, company licensing, and market conduct examinations. But I cannot offer you any horror stories. Rather, the company line at Cincinnati Insurance seems to be "state regulation of insurance is sometimes challenging, but we can live with it." Nor is the current system of state insurance regulation grinding our operations to a halt.

But that is not to say that state regulation is without its flaws. The Cincinnati Insurance Companies believe the major problem with the current system of state regulation is the needlessly repetitive nature of the system. We simply do not believe that 34 separate jurisdictions need to regulate each and every aspect of our business. In many instances, regulation by an insurer's domiciliary state would be sufficient to protect all persons or entities with an interest in an insurance transaction or the operation of an insurance company.

The logic of just such a "one regulator" approach was recognized by Congress last year when the House unanimously passed H.R. 5637. That legislation provided that if a reinsurer's domiciliary State is an NAIC-accredited State or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, the domiciliary state would be solely responsible for regulating the financial solvency of the reinsurer.

We must hasten to add, however, that there are some aspects of the business of insurance which need to be regulated in every jurisdiction in which we conduct business. Of course, the devil is in identifying which aspects of the business of insurance demand multi-state jurisdiction and those in which one regulatory authority would be sufficient.

### An Alternative Reform Idea: Single-State & Multi-State Insurance Regulation

The need for reform has been acknowledged by the National Association of Insurance Commissioners (NAIC) and to its credit, the NAIC has spearheaded a number of efforts to reform and modernize state regulation. In his testimony before the Subcommittee on October 3, NAIC President Walter Bell reviewed the NAIC's reform efforts in a number of areas, including:

- Speed to market (interstate compact and SERFF/electronic rate & form filing)
- Solvency and guaranty funds
- Consumer assistance and education
- Fraud detection
- Turnaround time on rate and form filings
- Producer licensing
- Company licensing

The NAIC's efforts are laudatory but we do not feel they have adequately addressed the problem we see with needlessly repetitive regulation.

And we are even more unmoved by the proposal for an optional federal charter given the uniquely local nature of the business of insurance and our concern that an optional federal charter would unlevel the playing field by giving a distinct competitive advantage to larger-sized insurers over small and medium sized insurers like ourselves.<sup>1</sup>

We therefore suggest that consideration be given to a modernized state system of insurance regulation that would reserve certain areas of insurance regulation to a single-state regulator, most likely an insurer's domiciliary state, to the exclusion of all other states, and allow all states to regulate in those areas not reserved to a single-state regulator.

We realize there may be unintended consequences of an approach like this. And this may not be the solution to what currently ills state regulation of insurance. But we feel that it is this type of "outside the box" thinking that needs to be explored before we give up on state regulation in favor of anything federal in nature.

### Implementing a Single-State/Multi-State System of State-Based Regulation

Which aspects of insurance regulation should remain multi-state and which aspects should be reserved to a single-state regulator? Obviously, there would be many devils to work out in these details and my time this afternoon does not allow a scholarly review of how the various subjects of insurance regulation would be divided between single-state and multi-state regulation.

As a starting point, we would simply suggest that public policy makers consider the following areas of regulation as possibly being conducive to exclusive regulation by an insurer's domiciliary state: financial and solvency regulation, investments, product regulation, producer licensing and company licensing. This is by no means an exhaustive list and is simply offered as a starting point for discussion.

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<sup>1</sup> Instead of fixing what's wrong with state regulation, supporters of the optional federal charter would simply jump to a new federal system and leave the rest of the industry to deal with a state system still in need of reform. Many small and medium size insurance companies would not be able to afford to switch back and forth between state and federal regulation, thus they could potentially be stuck in a less favorable regulatory environment creating an unfair competitive disadvantage. There could be no greater unleveling of the playing field. A better course is to focus on what's wrong with state regulation and fix it for all competitors, as opposed to creating an optional system that will benefit one group of competitors over another.

As to how such a system of state-based regulation might be implemented, the devil is again in the details. That being said, we believe that the approach embodied in H.R. 5637 (targeted federal legislation identifying specific areas of insurance regulation reserved to the regulator of an insurer's domiciliary state) is worth consideration.

### Conclusion

We appreciate the opportunity to share our views the problems we see with the current system of state regulation (needlessly repetitive regulation), emphasize our support for a continued system of state insurance regulation, and suggest that public policy makers and interested parties may need to take a fresh approach to insurance regulation reform and consider alternatives to the current proposals on the table.

As to whether a modernized system of state insurance regulation that divides regulatory authority between an insurer's domiciliary state and all other states will work, or is the right solution, we do not know. But we think it is representative of the type of thought and consideration that needs to become part of the debate over insurance regulatory reform before any decisions are made.

In addition, we incorporate by reference the views we expressed on the topic of state insurance regulation in a hearing before the Subcommittee in 2002, in which offered a detailed analysis of the benefits of state regulation from the consumer's perspective. A copy of that 2002 testimony is attached.

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ON

REGULATION AND COMPETITION IN THE INSURANCE INDUSTRY

JUNE 18, 2002

Introduction

Good afternoon Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is Scott A. Gilliam. I am Director of Government Relations for The Cincinnati Insurance Companies, headquartered in Fairfield, Ohio, just north of Cincinnati.

Our group of companies market property and casualty insurance and life insurance in 31 states through an elite corps of fewer than 1,000 local independent agencies. With nearly one million policies in force insuring businesses and families, our parent company, Cincinnati Financial, is among the 17<sup>th</sup> largest publicly traded property and casualty insurer based on 2001 revenues of \$2.5 billion.

This is the third in a series of hearings by the Subcommittee to examine regulation and competition in the insurance industry. These hearings come at a time when the current system of insurance regulation is under scrutiny by insurance companies, regulators, agents, consumer groups, trade associations and Congress. A re-examination of the current system and the need for reform is necessary and healthy and I commend the Subcommittee for holding these hearings.

I was asked to talk about consumer protection issues and how they impact the question of whether insurance regulation should remain a state-based system or whether a Federal approach to insurance regulation should be considered. While consumer protection issues will be the anchor of my remarks today, I cannot avoid sharing my company's concern about the future of insurance regulation and those who seem poised to jump to a Federal system for a quick fix. Nor can I avoid sharing our long held belief that the states are in the best position to satisfy the public policy objectives of insurance regulation—to protect consumers by assuring the financial soundness and solvency of insurers, promoting competitive markets, and enforcing insurance laws.

Consumers Are Served Best By State Regulation

Consumers clearly have an enormous financial and emotional stake in ensuring that the promises made by insurance providers are kept. Collectively, the insurance premiums paid for property/casualty and life

insurance products by American insurance consumers in 2000 amounted to over \$730 billion. With numbers like these, the interests of insurance consumers must be at the forefront of the debate over state versus Federal regulation of insurance.

We believe the state insurance regulatory system has served insurance consumers well over the past 150 years. For consumers, the strengths of the state-based system of insurance regulation lie in its ability to respond to consumers, to adapt to local market issues, and to enable states to experiment and learn from each other. State insurance commissioners become experts in the individual state issues they face, enabling other commissioners to learn from their experience. In that way, the insurance regulatory system evolves to meet new challenges.

Accessibility is another advantage that state insurance regulation has over the Federal regulation insofar as consumers are concerned. No one can quarrel with the fact that it is easier to deal with regulators in the consumer's home state than by having to call Washington or contact a regional Federal office in order to get help with a consumer insurance issue.

The accessibility of insurance regulators to consumers would also suffer under an optional Federal charter system given the likelihood of consumer confusion with the two systems. Under an optional Federal charter system, state-chartered insurers and Federally chartered insurers would operate side by side in the states. Under those circumstances, consumer access to regulatory protection would become needlessly complicated by the mere existence of dual regulatory systems and the resulting confusion as to which system has jurisdiction over a particular consumer complaint. Protecting consumers during the sales process would be even more problematic, since many state-regulated agents would also be selling products offered by Federally chartered insurers, further complicating the question of which system has jurisdiction over a particular transaction. Insurance consumers should not have to roll the dice when deciding whom to contact for a problem.

The warning made by Chairman Oxley in his opening statement last week, that consumers can not be adequately protected if insurers are subject to conflicting requirements at the Federal and state levels, seems equally applicable to the situation insurance consumers would face with conflicting Federal and state consumer protection systems.

It is also doubtful whether the Federal government would have the resources and expertise necessary to effectively and efficiently protect insurance consumers. It would take a huge effort to duplicate the activity of the states in this regard. Consider these facts:

- In the year 2000, insurance consumers made approximately 4 million consumer inquiries and complaints to state regulators.
- State insurance regulators employ 12,500 regulatory personnel nationwide and spend \$853 million annually to be the watchful eyes and helping hands on consumer insurance problems (2000 data).

The numbers are no less significant for Ohio, which handled over 126,000 insurance consumer inquiries regarding companies and agents last year. The Federal government is simply not equipped to take on such a role and develop a regulatory authority for insurance consumer protection as sophisticated and widespread as a state system that has been 200 years in the making. And as we have seen many times, Federal regulatory systems often become self-perpetuating and non-responsive to the needs of those they regulate and protect. To ensure effective consumer protection and consistent quality and dependability for

the vast array of products now available in the insurance marketplace, state regulation should remain the only vehicle for protecting insurance consumers and regulating our good industry.

#### The Benefits of State Regulation to Insurance Companies Also Benefit Insurance Consumers

The benefits of the state insurance regulatory system on insurance companies also translate into benefits for insurance consumers in the form of competitive markets. Consider the following attributes of state-based insurance regulation which ultimately benefit consumers:

Unique knowledge of the markets and local conditions. The states are the only logical choice for the comprehensive regulation of insurance given their unique knowledge of local markets and conditions. State regulators know the insurance markets within their borders. Although there are uniform national concerns in this industry, as in many others, in uncountable ways insurance involves concerns of an intensely local nature. The concerns in Ohio, for example, with its multiple urban centers, lake-front communities, and manufacturing base, are quite different from the insurance issues raised in Iowa, with its thousands of farmers and few large urban areas.

Less risk of regulatory mistakes. Under state regulation, good regulatory initiatives spread to other states and, conversely, the bad ideas tried in one state prevent others from making the same mistakes by offering real-market examples. Having fifty different regulators is less risky than gambling on a single Federal regulator who might have an axe to grind against the insurance industry—and ultimate power over the industry to swing the axe.

Anti-competitiveness. Federal regulation will create an unlevel playing field between those insurers who opt for Federal regulation and those whose insurance activities continue to be regulated by the states. With two completely separate and uncoordinated systems of regulation, there will be no uniformity in the forces and pressures competing insurers face as a result of regulatory oversight. With separate and competing systems of rate and form regulation, underwriting requirements, market conduct regulation, insolvency requirements, and other critical aspects of insurance regulation, another unnatural force will enter the insurance marketplace: choice of regulatory scheme (state or Federal). That will result in an unfair and anti-competitive distribution of market advantages and disadvantages based on choice of regulatory system, and it will destroy the level playing field on which our industry now competes.

The risk of a Federal advocate. Some argue that the insurance industry needs a Federal regulator who will fight for our interests against other financial institutions and advocate our views before Congress, just as the Securities and Exchange Commission and the Office of the Comptroller of the Currency champion the securities and banking industries. But consider the other face of Federal regulation: a single Federal regulator with ultimate power over an industry and an axe to grind. And as we have seen many times before, Federal regulatory systems often become self-perpetuating and non-responsive to the needs of those they regulate.

Flexibility. The attributes of an ideal insurance regulatory system include reasonableness, flexibility, adaptability to local markets, regulator expertise, and the ability to spread the risk of bad regulation. Federal regulation cannot compete with state regulation in these areas.

State regulation encourages innovation. Insurance companies often use a particular state as a laboratory for testing new product ideas or competitive strategies before they are introduced on a national level. Good products and good competitive strategies in one state often spread to other states. Likewise,



unsuccessful strategies in one state often educate the rest of the industry and lead to better products and more competitive markets in other states.

New Federal bureaucracy. At a time when Congress is seriously considering empowering states in a myriad of areas, Congress should not strip the states of their authority to regulate in a business arena that has been within their virtually exclusive domain throughout this country's fruitful history. The last thing America needs is another Federal bureaucracy.

#### Modernizing And Streamlining State Regulation To Reflect The Changing Face Of The Industry

Since 1945, the insurance industry in the United States has been regulated by the states under authority of the McCarran-Ferguson Act. While state regulation of insurance has worked very well, the realities of changing market conditions, including globalization, financial services convergence, and consolidation, demand a more efficient regulatory system, including greater coordination and consistency across states.

While some are calling for Federal regulation to address the changing face of the insurance industry, we feel state regulation still works best. At the same time, we realize that in order to preserve state regulation during these changing times, the current system of state-based insurance regulation needs to be modernized, streamlined, and made more efficient.

A strong and growing effort is already underway within the National Association of Insurance Commissioners ("NAIC") to modernize state insurance regulation and a national regulatory agenda appears to be taking hold. In March 2000, the NAIC recognized that the realities of changing market conditions, including globalization, financial services convergence, and consolidation, demanded a more efficient regulatory system, including greater coordination and consistency across states. The NAIC responded by laying out its vision for the future in the unanimously adopted "Statement of Intent: The Future of Insurance Regulation," explaining as follows:

"Fueled by enhanced technology and globalization, the world financial markets are undergoing rapid changes. In order to protect and serve more sophisticated but also more exposed insurance consumers of the future, insurance regulators are committed to modernize insurance regulation to meet the realities of an increasingly dynamic, and internationally competitive financial services marketplace. This will include working with all parties to combat and reduce the incidence of fraud, thereby providing a safer environment for consumers and lower costs.

"We pledge to work cooperatively with all our partners – governors, state legislators, Federal officials, consumers, companies, agents and other interested parties – to facilitate and enhance this new and evolving marketplace as we begin the 21<sup>st</sup> Century."

Since the issuance of its Statement of Intent, the NAIC has been working to refine its vision for regulatory modernization through the development of detailed proposals to streamline the state insurance regulatory system. Confident in its belief that functional insurance regulation at the state level is the best insurance regulatory system, and showing commitment to its charge to protect consumers, keep insurers and producers accountable, and maintain a sound and non-discriminatory insurance regulatory system in the United States, the NAIC is already making significant progress in several critical areas of regulation. These include:

- promulgation of a uniform producer licensing model act and passage of the act or other uniform licensing laws by 46 states with the intent of satisfying the reciprocity licensing mandates of GLBA's NARAB provisions
- several speed to market initiatives, including a system for electronic rate and form filing, the implementation of rate and form filing checklists and review standards in forty-four jurisdictions to speed product approval, and two initiatives to create a single point of filing for new life, health and annuity products (an interstate collaboration initiative and the coordinated advertising, rate and form review authority)
- several initiatives to create uniformity in company licensing and corporate governance (the uniform certificate of authority application and the "national treatment" initiative)
- an initiative to coordinate the review of holding company transactions that impact insurance subsidiaries domiciled in multiple jurisdictions
- an effort to institute a "lead state" framework for financial regulation
- promulgation of uniform privacy laws and regulations and the passage of new privacy protection laws and regulations in forty-nine states and the District of Columbia to GLBA requirements
- several initiatives to enhance consumer protection, including an interactive web tool specifically created for consumer research of company complaint and financial data
- several initiatives to build a more effective and nationally coordinated market conduct and regulation system

We would be remiss if we did not acknowledge that these efforts by the NAIC to modernize state insurance regulation are only a start. Virtually every area of insurance regulation needs to be improved if the state-based system is to meet the challenges of a modern insurance market. But unlike those companies who would abandon the state-system and start over with Federal regulation or dual regulation, The Cincinnati Insurance Companies are committed to doing the hard work needed in the state capitols to modernize, streamline and increase the efficiency of state regulation, and preserve its use as the preferred method for insurance regulation and consumer protection.

We believe the road to regulatory reform runs through state capitals, not through Washington, D.C., and in the end insurance consumers will be the ultimate beneficiaries of this approach to reform.

#### Using Congressional Action To Encourage Regulatory Modernization In The States

While we believe Congress should defer action on optional Federal insurance charter legislation until the states have had a fair amount of time to institute the necessary reforms themselves and modernize, streamline and increase the efficiency of state regulation, we realize the states may need encouragement to carry the ball into the end zone. While state regulators and the NAIC can recommend standards for reform and raise the profile of important reform issues, we realize that they cannot act alone. They need state legislators and governors to engage in the process and enact the fundamental insurance regulation reforms necessary to modernize state insurance regulation in the 50 states.

But what if the states do not follow the lead of state insurance regulators and the NAIC and enact the reforms needed to modernize, streamline and increase the efficiency of state regulation, or do not act soon enough or do enough to reinvigorate state insurance regulation? In this event, we are intrigued by the possibility of using Federal legislation to encourage the states to undertake more rapid and comprehensive reform of state insurance regulation. While we are as yet undecided on the form such legislation should take, we would prefer a model that would allow the NAIC to be active in crafting the reform legislation states would need to enact to avoid Federal regulation.

We would also suggest that Congress avoid the use of a one-size-fits-all approach and instead consider a variety of legislative tools which could be employed on an issue-by-issue basis to take into account the realities of today's changing marketplace.

In suggesting that Congress consider the use of Federal legislation to encourage reform at the state level, we are mindful of the dangers incumbent in opening these issues up for Federal legislative debate. For example, a piece of legislation originally drafted for relatively narrow reasons could result in expansive new demands and expectations on the industry. While we recognize these dangers and are concerned about them, we believe that using Federal legislation to encourage reform at the state level as a last resort is certainly better than jumping hook, line and sinker into a Federal system of insurance regulation.

#### State Regulation Is The Preferred Method Of Regulation For All Lines Of Insurance

Many in the industry only think of my company as a property and casualty insurer. However, we do have a significant life insurance operation, the Cincinnati Life Insurance Company, which generated gross premium volume of \$122 million in 2001. In fact, the Cincinnati Life Insurance Company is a former member of the American Council of Life Insurers.

I bring this to your attention in reply to the growing refrain in Washington that life insurance is different from property and casualty insurance in several critical ways which make it better suited for federal regulation than property and casualty insurance. Some even seem to think that we should not think twice about lobbying off the life industry and handing it over to federal regulators.

My company strongly disagrees with this point of view and believes that state regulation works best for all aspects of the industry, including life insurance as well as property and casualty insurance. We want to see state insurance regulation modernized, streamlined and made more efficient for all lines of insurance and will do all we can to achieve this goal. A reformed system of state insurance regulation for all lines of insurance, including life, is far superior to an unproven system of Federal regulation.

#### Conclusion

For those who support Federal regulation or an optional Federal insurance charter, it is easy to argue in favor of Federal involvement, since the debate is mostly hypothetical. But when one compares any hypothetical Federal system with the system of state regulation already in existence, together with the improvements in state regulation already underway, the benefits of the state system for consumers and the industry far outweigh any perceived advantage of a Federal system.