



American Insurance Association

**UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES**

**HEARING ON**

**“THE NEED FOR INSURANCE REGULATORY REFORM”**

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**WRITTEN STATEMENT OF**

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**ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION**

Chairman Kanjorski, Ranking Member Pryce and Members of the Subcommittee: Good afternoon. My name is Bill McCartney, and I am Senior Vice President, Government and Industry Relations at the United Services Automobile Association (USAA) Group, a national, highly competitive, and fully integrated financial services company headquartered in San Antonio, Texas. Through its 22,000 employees, USAA provides insurance, banking, and investment products to over 6 million current and former members of the U.S. military and their families. In fact, USAA's mission, to which we devote our undivided attention, is "to facilitate the financial security of our members, associates and their families through provision of a full range of highly competitive financial products and services." The company's net worth is greater than \$13 billion and USAA owns or manages assets exceeding \$133 billion. USAA is known for its financial strength and outstanding service to its members, and has received numerous awards for customer service, privacy practices, employment for women, and support for our troops.

I am here to testify today on behalf of USAA and our property-casualty insurance trade association, the American Insurance Association (AIA), and its more than 350 members. We want to thank the Subcommittee for addressing an issue that is vitally important to the country, to USAA, and to AIA: the compelling need to modernize today's outdated and dysfunctional state insurance regulatory system.

The issue of insurance regulation, once thought to be the province of isolated industry practitioners and regulators, is now central to many of the critical public policy debates, including protection against natural catastrophes, national economic security in the face of

man-made catastrophes such as terrorism, and the financial strength and international competitiveness of the U.S. financial services sector. Moreover, insurance regulation is a significant topic of public concern because the U.S. financial services sector, in which insurance plays an important role, is the engine that drives our economy. Within this sector, insurance plays a unique role because it helps individuals and businesses assume the risks that are essential in life and business with the security of a strong financial safety net in place in the event of loss. Without insurance, societal innovations and advancement become more risky and less likely to become reality.

Today, we stand at a regulatory crossroads that may well determine the future of the insurance marketplace in the 21<sup>st</sup> century, its ability to respond effectively and efficiently to losses – catastrophic or otherwise – and the appropriate role of government. With this context in mind, I would like to share three observations about the property-casualty insurance system:

1. Our economy is not static and continues to become more complex every day. Consumer needs continue to expand and grow in conjunction with our economy. These evolutions have surpassed the current insurance regulatory environment's effectiveness and viability.

2. The current regulatory system inhibits innovation and international competitiveness.

According to two major reports on global competitiveness in the financial services industry (Schumer/Bloomberg and the U.S. Chamber), U.S. insurers wishing to operate on the world stage are hampered by restrictive regulation that their foreign competitors do not face.

Moreover, the flow of new capital in our industry is moving in one direction—offshore to jurisdictions with more rational regulatory systems.

3. A market-based *optional* federal charter can benefit consumers by reforming regulation and encouraging innovation, while retaining the state regulatory system for companies that wish to remain there.

USAA and AIA's other member companies firmly believe that state-based regulation has not worked effectively or efficiently. It does not allow the insurance industry to meet the needs of Americans or the businesses they run, but instead perpetuates a structure that breeds inefficiency and inconsistency, and is passively hostile to healthy, competitive markets and the U.S. consumers that rely on those markets. Costs inherent in state insurance regulation burden our members when they change policies, as is necessary when they are ordered to change residences (once every 18 months on average), often within days. Members of the U.S. Armed Forces should not be inconvenienced by the unnecessary regulatory roadblocks that the state-based system places in their way; nor should our civilian members, or other insurance policyholders, in today's modern, global economy.

### **Experience Demonstrates the Critical Need for Insurance Regulatory Reform**

I would like to focus today on those aspects of the state system that impede USAA and its members – and, frankly, all insurers and their consumers – from enjoying the full benefits offered by a market-oriented and uniform regulatory structure. I speak about the states'

regulatory shortcomings from “inside” experience. By way of background, from 1987 to 1994, I was Nebraska’s Director of Insurance and was privileged to serve as President of the National Association of Insurance Commissioners (NAIC) in 1992. I have always believed that the primary and overarching focus of insurance regulation must be the financial condition of insurance companies. And I used to believe that the states could achieve uniformity and consistency of regulation without federal intervention.

During a hearing before the Oversight and Investigations Subcommittee of the House Energy and Commerce Committee in the early 1990’s, I asked Congress to give states the time necessary to effect the changes that we had identified. I also said that, if the states proved unable to make those changes, I would be the first to admit it to Congress. It’s been 15 years, but here I am.

I still have many friends engaged in the regulation of insurance in the states, and this is not an indictment of the people who toil in state regulation. Most of them are very professional and want to do the right thing, but they labor under a framework that has not been meaningfully changed in more than 62 years. Even when the regulators are unanimous in their view of what needs to be done to address a national issue, it is impossible to implement it nationally. Excluding the District of Columbia and the US Territories, we have 50 separate regulatory agencies and 99 legislatures (Nebraska’s Unicameral only counts once; the other states count twice). Experience has shown that it is close to impossible for an NAIC model law to be uniformly enacted nationally. That may not have been much of a problem in 1945—the last

time Congress fundamentally addressed insurance regulation by enacting the McCarran-Ferguson Act. Back then, most people resided in one state for their entire lives.

Much in this country has changed since then—great societal, economic, and technological changes. Society has become highly mobile. This is especially true of USAA's members. Each year, a third of our active duty members undergo a move. For most of the financial products they have with USAA, a simple change of address form is all they need. But for their property and casualty products, that's only the beginning. Even though their risk profile has not changed because of the move, they can't take their automobile insurance and homeowners or renters policies with them as they can their credit cards and investment products. A move means a complete re-underwriting, re-pricing, and re-issuance of their property and casualty products and it also generally means different coverages in the new state than what they had in the state they just left.

Some argue that, because state tort laws, property risks, automobile insurance requirements (and, on the commercial insurance side, workers compensation laws) are so state-specific, a national regulator for property and casualty insurance products could never work. I strongly disagree. USAA, and I believe this to be true for other insurers, could readily develop standardized products that we could offer to our members that take into account all these state variations. The reason insurers have not done so—and the reason for an almost complete lack of innovation in this industry—is because it is so difficult and time-consuming to gain national approval of the innovations. Robert Kennedy used to favorably quote George Bernard Shaw who wrote, "Some people see things as they are and ask 'Why?'; I dream things

that never were and ask "Why not?" When it comes to insurance regulation, it is time for us to look for significant reform and ask ourselves, "Why not? Why are we continuing to do things as we did them 60 years ago?"

The NAIC will point to a number of initiatives that the states have undertaken to modernize insurance regulation as proof that the states are going to make the meaningful changes necessary to bring regulation into the 21<sup>st</sup> Century. While the NAIC is to be commended for trying, the proof is in the pudding, and the results of all of those efforts can be best summed up by the title of a Shakespeare play: *Much Ado About Nothing*. I know, because I was part of those efforts for seven years and have been watching the NAIC's fits and starts at reform since then.

Take, for example, the Interstate Insurance Product Regulation Commission (IIPRC), which just completed its first year of operation. The NAIC is pleased that 30 jurisdictions (29 states and Puerto Rico) are now members of the IIPRC. However, 21 states, including five large states—California, Florida, Illinois, New Jersey, and New York—have not joined (and the regulators in some of those states have stated that they never will join). In addition, the compact only deals with "asset protection insurance products, such as life insurance, annuities, disability income and long-term care insurance." The products offered by members of the AIA fall outside the IIPRC. While the IIPRC was created to "serve as a central filing point . . . enhancing the speed and efficiency of regulatory decisions and allowing companies to compete more effectively in the modern financial marketplace while continuing to provide

protection for consumers,” it adds a layer of bureaucracy and expense without reducing bureaucracy and expense in the state insurance departments.

Similarly, the NAIC points to its System for Electronic Rate and Form Filing (SERFF) (which does handle property and casualty insurance products) as evidence of its success in streamlining and modernizing insurance regulation. Again, while the NAIC must be commended for trying, the results have been mixed. While all 50 states, the District of Columbia, and two of the Territories have signed on to participate in the system, not every state allows all types of filings to be made through SERFF. SERFF was designed to be a single point of filing that would streamline the approval process; however, many states retain state-specific requirements that insurers must complete in addition to the generic SERFF form. How does it work in reality? Recently, USAA amended its auto policy to provide an online driver discount. We were required to file the change with every state. The filing was made through SERFF and, by the time all of the state forms were included, ran to one thousand pages. Because of its voluminous nature, I have not copied it as an exhibit to my testimony; however, you can draw your own conclusion whether or not a regulatory modernization and streamlining initiative that still requires a thousand pages of filings has been the success the NAIC claims.

While the NAIC has initiated other steps to modernize insurance regulation, to varying degrees of success, one in particular has had a very negative impact on USAA. When Gramm-Leach-Bliley was enacted in 1999, it contained a provision designed to modernize insurance regulation. It required states to achieve uniformity or reciprocity in their licensing

of non-resident insurance producers. Unfortunately, the NAIC was given latitude in how to achieve this and the course chosen greatly added to the regulatory burden at USAA, which markets products directly to our members, principally over the internet and by telephone. At the time the regulatory “reforms” were implemented by the states, USAA maintained roughly 33,400 total producer licenses. Today, that number has increased more than six times to nearly 205,000 licenses. That can hardly be viewed as regulatory streamlining and modernization.

While I have spent much of my time here today talking about the problems of inconsistency and non-uniformity in the state regulatory system, for property-casualty insurers, the states’ obsessive focus on government price and product controls is just as damaging to the competitive structure of the marketplace. I have always thought that the only function of regulatory oversight of insurance rates was to make certain that they are not imperiling an insurer’s solvency—the primary and overarching role of insurance regulation. But, over the course of my 30-year career in insurance, I have come to know that the existing regulatory approach at the state level is misguided; that the system of price and product controls empowers regulators, not consumers; that uniformity and consistency are not possible without federal intervention; and that continuing the current system will drive companies out of business and capital out of the United States.

Additionally, the unwieldy and misfocused nature of the regulatory system is contributing to the outflow of risk-bearing capital from the U.S. to jurisdictions with more rational and predictable regulatory systems. According to the CEO of one major offshore reinsurance company, a major consideration in choosing a domicile is the regulatory freedom it grants

while still maintaining "a credible regulatory environment and a sound operational infrastructure." Virtually all of the new capital that has entered the U.S. market since Hurricane Katrina has been domiciled in Bermuda, whose regulatory system "allowed reinsurance companies to enter the market on a timely basis. This was not possible in the United States under the highly fragmented and difficult state insurance regulatory system." This attitude speaks volumes about the competitiveness of the U.S. insurance industry under the current regulatory system and its less than promising future in our global economy if significant reform is not enacted.

### **A Better Regulatory Alternative**

It is high time for a change. We believe that an optional federal charter approach, which relies on a combination of free markets and a tightly re-focused regulatory system, represents our best opportunity to advance regulatory modernization that works for consumers, the industry, and the economy. This is a regulatory system that has worked well in the banking industry for well over a century, and will modernize the insurance industry if adopted.

We strongly support the National Insurance Act of 2007 (H.R. 3200), introduced in July by Reps. Melissa Bean (D-IL) and Ed Royce (R-CA), along with its Senate counterpart. This legislation would modernize insurance industry regulation by providing an optional federal charter (OFC) for insurers that choose to be regulated at the federal level, while keeping the state-based regulatory system in place for companies that choose to remain state-regulated. For national companies, an optional federal charter would displace the current multi-state patchwork regulatory system with a national framework that provides uniformity,

consistency, and clarity of regulation—thus allowing them to meet the consumer demands and operational imperatives of the 21<sup>st</sup> century. H.R. 3200 embodies all of the elements of this paradigm and represents the best approach for Congress to move forward in advancing reform.

H.R. 3200 does not regulate prices charged by market participants, because it recognizes that governments, acting unilaterally in these areas, cannot be effective surrogates for the free market. Free market pricing has been successful in virtually every other industry within the financial services sector, as well as the few states where insurance rates are lightly regulated or not regulated at all.

As a substitute for price controls, H.R. 3200 places regulatory emphasis on ensuring that companies are financially sound and that consumers are protected from misconduct by market participants. These are core regulatory functions for most industries, and insurance should be no exception. In addition, the optional federal charter would bring needed uniformity for those choosing a national license, while respecting the decisions of others to remain under state regulatory authority.

Thus, H.R. 3200 effectuates a fundamental shift in regulatory application. At the same time, H.R. 3200 does not preempt state premium tax regimes or abandon aspects of the state system that are necessary for consumer protection. In this respect, the Act recognizes that there always will be a need for markets of last resort – so-called “residual markets” – and that national insurers must participate in those markets when participation is mandated by state

law. In addition, the Act requires national insurer participation in state-mandated statistical and advisory organizations, and workers' compensation administrative mechanisms.

By de-emphasizing those aspects of regulation that tend to politicize insurance and weaken the private market, H.R. 3200 establishes stronger, re-focused regulation in those areas where regulation is necessary to protect consumers as they navigate the system. Above all, enactment of H.R. 3200 will assure that the insurance safety net remains strong despite the ever-changing nature of risk.

For insurance consumers, the Act establishes both a federal ombudsman to serve as a liaison between the federal regulator and those affected by the regulator's actions, as well as consumer affairs and insurance fraud divisions to provide strong consumer service and protection.

Over the long-term, it is our view that a federal regulatory option, structured in the way set forth in H.R. 3200, will modernize regulation of the industry, empowering consumers and emphasizing market conduct and financial solvency oversight in the process. In creating these needed systemic reforms, the Act will consolidate regulation into a single uniform point of enforcement for those that choose the federal charter, without forcing change for those remaining in the state system.

### **The Critical Need to Move Forward**

Insurance regulatory reform is not an academic exercise; it is a critical imperative that will determine the long-term viability of one of our nation's most vital economic sectors, and help define how our economy manages risk in the future. The choice is between the existing state regulatory bureaucracy or a new approach that relies on the hallmarks of the free market and individual choice and recognizes the evolution of consumers' needs in our global economy.

As the Subcommittee considers reform of the current system, we believe that the three basic principles that define the optional federal charter approach in H.R. 3200 must be followed:

- ✓ place primacy on the private market, not regulatory fiat, creating an environment that empowers consumers as marketplace actors;
  
- ✓ focus government regulation on those areas where government oversight protects consumers in the marketplace, such as financial integrity and market conduct, rather than on those activities that distort the market, such as government price controls and hostility to innovation; and
  
- ✓ establish uniform, consistent, and efficient regulation.

We believe it is very important for the Subcommittee to judge any reform proposal against these principles to ensure that any legislation that may be enacted does not create or add more unnecessary regulatory burdens, does not inadvertently restrict the options that a vibrant private market can offer to consumers, and adds efficiency and strength to insurance regulation.

Creating an optional federal charter is imperative to meet the needs of customers and insurers, alike. We appreciate your interest in this important subject and look forward to working with you to improve our nation's insurance regulatory system. Thank you for the opportunity to appear before you today.