

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Oversight and Investigations
And the
Subcommittee on Financial Institutions
and Consumer Credit

Committee on Financial Services
United States House of Representatives

Regarding:
Information Sharing Among State and Federal
Financial Regulators

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Testimony of Terri Vaughan, Vice President National Association of Insurance Commissioners

Introduction

My name is Terri Vaughan. I am the Commissioner of Insurance for the State of Iowa, and this year, I am serving as Vice President of the National Association of Insurance Commissioners (NAIC), as well as Chair of its Coordinating with Federal Regulators Working Group. This is a particularly challenging time for state insurance regulators as we work to improve our system of supervision and fully implement the requirements of the Gramm-Leach-Bliley Act (GLBA). I am pleased to be here on behalf of the NAIC and its members. We want to work with the Financial Services Committee to identify our respective information needs and perfect the exchange of this information among federal and state regulatory agencies, particularly in the area of fighting fraud.

As insurance issues have just recently been added to the responsibilities of the Financial Services Committee, Attachment A of my testimony includes a brief summary of the role state insurance departments and the NAIC play in supervising the business of insurance in the United States.

Today, I would like to make three points regarding regulatory information sharing in response to financial modernization and legal requirements of the Gramm-Leach-Bliley Act and federal anti-fraud statutes –

- First, the NAIC and state insurance regulators regard information sharing as the cornerstone for implementing the provisions of GLBA as intended by Congress. We are well along the path of putting into place the procedures necessary to make information sharing among state and federal agencies a practical reality. Our efforts include sharing information on fraudulent activities in the marketplace.

- Second, on behalf of the states, the NAIC already has in place sophisticated online systems for sharing regulatory data among the states concerning licensing, financial monitoring, consumer complaints, and enforcement matters. We want to remove existing barriers and expand the reach of these resources so that state insurance departments can readily exchange such critical regulatory information with federal banking and securities regulators.
- Third, the NAIC and the states need help from Congress in gaining access to federal law enforcement records and removing impediments that prevent state insurance departments from easily sharing information with their federal counterparts. In particular, we want to move very quickly on closing the information gaps that prevented state regulators from checking on securities violations committed by Martin Frankel before he got involved in the insurance industry.

Good Financial Regulation Starts with Having Good Information

The Gramm-Leach-Bliley Act establishes a new order of functional financial regulation that depends upon active cooperation and information sharing among several federal and state agencies to be effective. Although this approach is novel at the national level, it is well known among state insurance regulators who have been working together through the NAIC for more than a century. The NAIC serves our need for a national support organization with top quality technical and analytical resources to supplement the in-house resources of each state insurance department.

Like all financial regulators, state insurance departments need easy access to good information in order to be effective. We decided long ago that one of NAIC's core missions should be collecting, managing, and disseminating regulatory information centrally on behalf of its members, who are the chief insurance supervision officials in each of the 50 states, the District of Columbia, and the U.S. territories. Consequently, the NAIC has focused much of its resources on being a leader in developing useful

computer-based systems to help insurance regulators share information produced by themselves, as well as the companies and agents they supervise.

NAIC Maintains Valuable Insurance Databases Needed by Financial Regulators

Today, the NAIC spends almost half of its total resources to maintain a substantial information management division that is a national leader in all respects. To design and operate its numerous databases used by state regulators, businesses, and the public, the NAIC employs 170 people and spends approximately \$20 million each year. Moreover, we are using the Internet and other emerging technologies to make NAIC's regulatory databases more easily available to over 10,000 employees of state insurance departments.

The following snapshot of the NAIC's database operations will give you an glimpse of our extensive resources –

- The NAIC operates a newly constructed technology center in Kansas City housing the world's largest insurance regulatory database.
- The NAIC's financial database contains a 15-year history of annual and quarterly filings on 5,200 insurance companies, representing 98% of written premiums in the United States.
- The agent database contains background and licensing information on 2.5 million agents representing 87% of all active producers. This database includes regulatory actions that have been taken to ensure that only qualified professionals are licensed to sell insurance to consumers.
- The consumer complaint database includes information on 1.5 million closed consumer complaints, broken down by type, reason, disposition, count, and trend analysis.

- The formal adjudicated regulatory actions database became operational in the 1960's, and was computerized in 1985. There are more than 120,000 actions in the database regarding insurance companies and agents. This information is publicly available.
- A special database for investigations has been operational since 1989. It tracks suspicious activities, and includes 7,200 entities and 11,800 activities. This information is only available to regulators.

State Insurance Regulators Have Already Begun the Process of Sharing Information with Federal Regulators under GLBA

Establishing sound working relationships with Federal regulators is absolutely essential for state insurance departments under GLBA. In fact, it is so important that NAIC was actively engaged in establishing a sound regulatory dialogue with our federal counterparts before GLBA became law. After enactment of GLBA, the NAIC decided to consolidate its efforts under a new Coordinating with Federal Regulators Working Group, which I chair. Recognizing the importance of this initiative, our members gave the Working Group broad responsibility to stimulate cooperation at all levels.

The basic ingredient for making regulatory cooperation a success is for agencies to jointly agree upon a process that is workable. Thus, NAIC's first priority was to negotiate written cooperation agreements that can be used to open information channels between state insurance departments and federal banking and securities regulators. These model agreements lay out the ground rules for sharing information and keeping it confidential when necessary.

The project to negotiate written information sharing agreements has been a great success. To date, the NAIC has successfully negotiated agreements with the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Office of Thrift

Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC). These agreements cover broad exchanges of regulatory information relating to the financial solvency, enforcement matters, routine licensing, and consumer complaints. They are also designed to stand the test of time and inevitable changes in information needs and technologies.

The next step is securing individual agreements by each of the state insurance departments with each of the participating federal agencies. We are farthest along with OTS, which has signed information sharing agreements with 41 states during the past year. Finishing touches on similar model agreements with the Federal Reserve Board, OCC, and FDIC have just been completed. We expect most states to sign individual agreements with these agencies during 2001.

NAIC Has Existing Technical Ability to Share Database Information with Federal Regulators If an Anti-fraud Network Can Be Established

The NAIC has the technical infrastructure in place now to share regulatory database information with federal agencies. Because NAIC is the central database manager and link to individual state insurance department computer systems, we have developed a modern online information exchange system that should have no difficulty in expanding its reach to include federal agencies. Likewise, NAIC is fully capable of receiving and handling both public and confidential regulatory information. In fact, the NAIC may be able to offer guidance in setting up a workable system to agencies having less experience in this area.

We do have strong views on how a multi-agency information exchange system should be structured –

- Create a national anti-fraud network based upon information sharing agreements among functional financial regulators and law enforcement agencies.

- Establish a central database authority to set technical standards for sharing regulatory and law enforcement information. In December 1999, the NAIC attempted to join the Federal Financial Institutions Examination Council (FFIEC) as a means of coordinating on technical matters with federal banking regulators. We were not permitted to join FFIEC, but we still believe there must be a central governing organization where all functional regulators can meet together and set necessary policy and technical standards to make mutual sharing of information a practical reality. For example, the NAIC would like a central governing body to establish the well-known and freely available “XML” language as the common Internet standard to facilitate information exchanges among different regulatory databases.
- A multi-agency information sharing system should link existing databases rather than create new ones. Each regulator has a large investment in its own systems and databases, including training and integration. Functional regulators need to work within their own unique system interface, but will require access to data stored on outside databases in order to be effective.
- Finally, all participants in a multi-agency system should be given legal immunity for good faith reporting of regulatory information and operation of the system.

State Insurance Regulators Need Immediate Access to FBI’s Fingerprint Database

While NAIC supports Congressional efforts to create a broad anti-fraud information sharing network, we strongly urge you to fix one glaring weakness in the system immediately. Right now, state insurance regulators are the only functional regulators who do not have access to the Fingerprint Identification Record System (FIRS) operated by the FBI. Congress should close this gaping loophole before doing anything else.

Permitting states to run national fingerprint background checks on insurance agents and company personnel is the best way to weed out known wrongdoers before they get a chance to commit insurance fraud. It is also critical if Congress expects the states to establish a national agent licensing system, as mandated by Subtitle C of Title III of GLBA (National Association of Registered Agents and Brokers).

In addition, the federal criminal law punishing insurance fraud (18 USC 1033) establishes an affirmative duty for state insurance regulators and private employers to check the criminal history of certain persons, yet there is presently no uniform access method for us to conduct such checks with the FBI's fingerprint database.

The General Accounting Office (GAO) specifically recommended that state insurance departments be granted access to Federal criminal history data as part of its report on Martin Frankel's activities (Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight; GAO/GGD-00-198, September 2000, page 50).

A few state insurance departments are able to use the FIRS system run by the FBI because they qualify separately as "law enforcement" agencies under rules promulgated by the Department of Justice. The NAIC surveyed the states to see where they stand on having access to FBI fingerprint files for background checks. Although 17 insurance departments have access to FIRS, most of them operate under state laws that do not meet Justice Department standards. We found that only three state insurance departments – California, Florida, and Idaho – have consistent access to the FBI database for routine checks of criminal history.

The fastest way to grant state insurance departments access to the FBI's fingerprint database is by federal statute. Beginning in 1999 and most recently last September, NAIC provided specific legislative language to the House Commerce Committee that would accomplish this important goal. Since then, we were able to meet with FBI officials and improve our proposed statutory language to incorporate the FBI's

suggestions. A copy of this updated language has been shared with the Financial Services Committee staff.

NAIC's proposed legislative language simply gives state insurance regulators the same access to FBI fingerprint files that banks, bank regulators, and the American Banking Association currently possess. We ask that you act quickly to put us on a level playing field with federal functional regulators.

State Insurance Regulators Need Access to NASD's Enforcement Database

State regulators need Congress to help us gain access to the national securities enforcement database maintained by the National Association of Securities Dealers (NASD). The NAIC has tried to negotiate appropriate access with NASD for two years, but we have not yet been successful. In return, we are willing to share with NASD the extensive database information NAIC maintains on insurance agents and companies.

The GAO specifically recommended that securities and insurance regulators exchange regulatory information in its Martin Frankel report (pp. 49-50). Enabling such useful exchanges would close one of the unintended gaps in GLBA. We believe closer coordination between securities and insurance regulators is becoming even more important as the products and sales of these products become further intertwined.

Regulatory Confidentiality Must Be Preserved for Information Sharing to Work

Congress should act quickly to guarantee the confidentiality of regulatory information exchanges between state insurance departments and federal agencies, especially in fighting fraudulent activities that have not been fully proven. The system of functional regulation set forth in GLBA requires that regulators communicate freely on all matters

of mutual interest. They cannot do so if they cannot maintain confidentiality for regulatory information.

During our efforts to negotiate regulatory cooperation agreements with the Federal Reserve Board, OCC, OTS, and FDIC, one of the biggest concerns was the protection of sensitive information when it passes from one functional regulator to another. Federal agencies are wary of state freedom of information laws, while states are equally concerned about the level of federal safeguards. In the end, because we could not resolve the confidentiality questions in a manner that could apply to all states, the NAIC's model agreement anticipates that some states will alter it to fit their particular laws. As a result, we are unlikely to achieve a uniform nationwide level of confidentiality on information exchanges.

The NAIC has developed a series of model law amendments that would protect the confidentiality of insurance regulatory information nationwide if all states adopt them. However, that is a distant goal when facing the busy and time-limited schedules of state legislatures. Meanwhile, GLBA has created an immediate Federal interest in opening and protecting the flow of information among functional regulators.

NAIC recommends that Congress act quickly to enact a federal law that protects the confidentiality of regulatory information exchanges.

Conclusion

State insurance regulators and the NAIC fully support Congressional efforts to create a nationwide network of information sharing among regulators to fight financial fraud. We are ready to share the information in our own regulatory databases in exchange for receiving the information held by securities and banking regulators. The NAIC also possesses a high level of technical expertise and resources to implement a national

database system quickly if it is built upon networking our existing facilities instead of building new ones.

The most urgent need, in our opinion, is for Congress to open the doors to the FBI fingerprint and NASD enforcement databases, as well as to protect the confidentiality of regulatory information. In view of its lengthy history and the daily exposure states and unwitting consumers face without such FBI and NASD database access, we urge Congress to act on NAIC's recommended FBI access legislation immediately, and also take whatever steps are needed to grant state insurance departments access to the NASD database. These critical tools should not be left waiting while Congress determines how other elements of a national anti-fraud information program should be implemented.

In all these areas, we pledge our commitment and cooperation, and we appreciate the opportunity to participate in this important regulatory modernization initiative.

ATTACHMENT A

Background on State Insurance Regulation and the NAIC

- All insurance providers doing business in the United States are supervised by State insurance departments operating under legal authority conferred by individual States and the Federal government. These departments work together with other State and Federal agencies to form a national regulatory system strengthened by the checks and balances associated with separate scrutiny.
- To enhance the effectiveness of State regulators, the National Association of Insurance Commissioners (NAIC) was formed in 1871 as a non-profit organization for coordinating the supervision of insurance providers, developing higher standards, and providing expert technical and professional support services to State insurance departments. The NAIC's members are the chief insurance regulatory officials of the 50 States, the District of Columbia, and four U.S. territories. Many regulatory functions which are best done centrally – such as data collection, securities valuation, and liaison with international regulators – are performed through the NAIC.
- State insurance departments, together with the NAIC, have two primary mission goals:
 1. Protect the public interest, promote competitive markets, and facilitate fair treatment of insurance consumers; and
 2. Promote the reliability, solvency, and financial soundness of insurance providers selling products in the United States.
- The record of State regulators in meeting these goals is quite impressive. During the 1980's, many insurers faced severe financial strains similar to those encountered by Federally-insured deposit institutions. However, the level of insolvent insurers under State supervision never approached the crisis level of insolvent deposit institutions that were rescued by the Federal government.
- Congress specifically recognized the strength and expertise of the State regulatory system in the McCarran-Ferguson Act (15 U.S.C. Sec. 1012). That Act states in part: "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." Through the Gramm-Leach-Bliley Act in 1999 (P.L. 106-102), Congress reaffirmed the McCarran-Ferguson Act and designated States as the functional regulators of all insurance activities by banks, securities firms, and traditional insurance providers.
- The existing State system of insurance solvency and market conduct regulation does not cost the Federal government anything. Unlike the banking and securities

industries, there is no Federal guarantee program to compensate insurance consumers when insolvency occurs. Instead, the costs of insurer failures are handled through State-sponsored guarantee funds. If the States do a poor job of regulating, their taxpayers and citizens directly feel the costs of insolvent companies. State governments thus have a powerful incentive to do the job well.

- Insurance is an enormous industry that generated \$898 billion in premiums during 1999. Across the country, State insurance departments employ more than 10,400 people and will spend \$910 million on regulation in 2001. These extensive human and financial resources are focused exclusively on the monitoring and enforcement tools needed to supervise thousands of insurers, agents, and brokers participating in the insurance business.