

TESTIMONY OF
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SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT-SPONSORED ENTERPRISES
OF THE HOUSE FINANCIAL SERVICES COMMITTEE

ON

REGULATION AND COMPETITION IN THE INSURANCE INDUSTRY

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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 17th 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 21st 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.