TESTIMONY OF

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FOR GOVERNMENT AFFAIRS AND INDUSTRY RELATIONS

GUARD FINANCIAL GROUP

ON

"Insurance Regulation and Competition for the 21st Century"

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

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Chairman Baker, Ranking Member Kanjorski and members of the Subcommittee, my name is Wayne E. McOwen and I am Senior Vice President for Government Affairs and Industry Relations for Guard Financial Group, headquartered in Wilkes-Barre, Pennsylvania. I thank you for the opportunity to offer commentary on the Optional Federal Charter for insurers, and I join my industry colleagues in applauding your diligent and enthusiastic commitment to the issue of insurance regulation reform.

GUARD Financial Group (GFG) is a corporate holding company for the following insurance, banking and investment operations: GUARD Insurance Group (GIG), a Workers' Compensation specialist that provides coverage and an extensive array of customer services to businesses through three insurance affiliates licensed in 27 jurisdictions including the District of Columbia; GUARD Security Bank (GSB), a federally chartered thrift and a "virtual" operation that uses electronic communications -- in lieu of branches -- to enhance service, reduce overhead and provide the most competitive products to its customers; and GUARD Capital, which facilitates entry into the sale of investment products by guiding producers through the licensing and compliance process.

As the nature of these enterprises suggests, our organization is subject to both state and federal regulation. Over the past several years, the expansion of our insurance operations has provided first-hand experience with regulatory processes in multiple states. Enabled by Gramm-Leach-Bliley, our organization’s entrée to banking required considerable interaction with the Office of Thrift Supervision (OTS) in the chartering of GSB. My purpose today is not to defend or advocate one system of regulation over the other; but, rather, drawing on these contemporary experiences, to offer observations that may provide insights into the advantages of choice.

As requested, my comments will be in two parts: 1) Observations on the regulation of insurer business practices, or Market Conduct as it is known in the industry; and, 2) Reflections on regulatory choice and regulatory competition – why the coexistence of state and federal regulators could

make sense for insurance segments of the financial services industry to the advantage of all stakeholders.

MARKET CONDUCT CONSIDERATIONS

State regulators focus on two primary aspects of insurance company operations: financial viability and general business practices. Oversight of these areas is achieved by a process of examinations. The intent is to identify variances from established standards and recommend appropriate remedial action where necessary.

Financial examinations scrutinize and monitor insurer solvency, the primary public policy objective of insurance regulators. A series of defined ratios serve as an early warning system to identify potential problems. Examiners screen for adherence to risk-based capital requirements, strict investment policies, and statutory accounting principles among other financial standards. The process is as precise as mathematics.

A market conduct examination is the mechanism by which insurers' general business practices are evaluated. Whereas all states focus on the **objective** components of an insurer’s financial health, the evaluation of insurer business practices is neither universal nor uniform and, therefore, can be somewhat **subjective**. However well intended, under these circumstances, such provisions are of limited benefit to consumers and of maximum concern for the industry.

State insurance statutes contain provisions aimed at preventing unfair or deceptive practices, restricting unfair competitive practices, prohibiting activities that are arbitrary or capricious in the administration of policies

and fraud. Definitions of prohibited activities can vary widely. For example, what constitutes “fair” treatment of policyholders and claimants, or what might be considered to be “arbitrary” or “capricious” insurer action, is open to varying interpretations from one jurisdiction to another – sometimes from one examiner to another. Examiners may be regulatory staff, or, in some instances, the process is outsourced by regulators to contract examiners. That consumer protections have been and continue to be a priority of state insurance regulators is unquestionable. It is also true, however, that inconsistencies among jurisdictions can make the process complex and unnecessarily costly, ultimately limiting the benefits to stakeholders.

Even when statutory wording is identical, the interpretation of regulations can vary from jurisdiction to jurisdiction. Carriers doing business on a multi-state basis are faced with the necessity of filing (and often re-filing) products in multiple variations to satisfy even the most modest differences in regulatory requirements in order to receive approval to market their products. This has engendered the need for insurers to create dedicated units staffed with compliance specialists to monitor and respond to the individual requirements of each state in which the carrier is approved to conduct business. Carriers may also find it necessary to engage external consultants to provide ad hoc regulatory requirement compliance assistance, resulting in additional fees for services and further raising the costs of doing business.

In some instances, it is not the interpretation of the requirement but the variations of that requirement that become problematic – particularly when benchmarks, against which carrier performance is measured, differ for no apparent reason. One example is in the area of cancellation notification. Although it might seem that adherence to time specific notification requirements should not be onerous, it can be. For instance, all jurisdictions have statutory notice requirements regulating coverage cancellation, and insurer adherence to these provisions is one area monitored by regulators. Such provisions vary from requiring as few as ten days to thirty days to as many as forty-five days notice to policyholders and/or to other stakeholders, such as a mortgagee. However, there is no clear rationale for why the policyholders of one state are accorded a

thirty-day notice, while those in another state receive only ten days. Although individual insurance consumers relocating from one state to another may be confused when they encounter these inconsistencies, a far greater problem is created for commercial policyholders engaged in multi-state operations. They must continually adjust their own business practices to keep up with how their insurance providers are required to deal with them on such issues. If the United States Postal Service were unable to provide consistent mail delivery from state to state, then differing requirements for the delivery of cancellation notices might be more readily understood. However, we know that, with the possible exception of service to certain remote areas, the delivery of mail is standard countrywide. For insurance carriers doing business in multiple states, and especially for those offering multiple lines of insurance, the patchwork of notification mailing requirements makes complex what might otherwise be a simple process, raising the cost of doing business to the detriment of the consumer.

The existence of uncodified procedures, sometimes referred to as “desk drawer” regulations, is also problematic for carriers. These unpublished and unpredictable procedural requirements can have significant consequences in terms of a carrier’s eligibility to become a new entrant in a state or to offer new products and services.

Inconsistency and fragmentation is also evident in the application of standards among different lines of business, personal and commercial, as well as in the application of regulations for a single line of business, both in multi-state scenarios and within a single state. For Workers’ Compensation, for example, the responsibility for business practices oversight may reside in more than one state regulatory agency. In some jurisdictions, those policyholder issues are the focus of the Department of Insurance, while claimant issues are the focus of a Workers’ Compensation Commission under the Department of Labor. Whether or not policyholders and claimants always share a common interest in the application of Workers’ Compensation coverage, when two agencies in one state share regulatory authority, outcomes can be unpredictable.

Additionally, the Market Conduct process is, by design, duplicative. Carriers are subject to scrutiny by the insurance department of their state

of “domicile,” as well as by the regulators of every state for which a license to do business has been granted. All exams are conducted at carrier expense. Exam conducted by the domestic regulator may be duplicated by other states’ regulators as they evaluate the identical business practices. This presents a high cost of doing business for carriers, not only in terms of multiple exam fees but in the downtime of staff assigned to working with examiners.

Ultimately, although multi-state insurers have become as fully engaged in interstate commerce as any bank or other financial enterprise, unlike these other segments of the financial services industry, insurers continue to be regulated by more than fifty individual systems with nearly as many sets of proprietary rules and procedures. For more than 100 years, a dual regulatory system has worked successfully for banking institutions. It is time to consider the potential advantages of that model for certain insurance operations and allow insurers -- and their customers – all of the benefits derived from choice.

OPTIONAL FEDERAL CHARTER: A MATTER OF CHOICE

Choice: America was founded on it! Competition: America thrives on it!
Why then is the prospect of regulatory choice for insurers and the resultant competition between state and federal regulators so difficult to accept? Is the insurance segment of the financial services industry so different, so less a factor in our economy that any measure of federal oversight is unnecessary or unwarranted?

Admittedly, an optional federal charter does not have universal appeal, but the operative word in the application of such a concept is “optional.” For insurers doing business in the multi-state arena, or for those who market a limited number of products with risk factors that are consistent from state-to-state, the advantages of streamlining the regulatory process under a

federal charter could be many. Ultimately, those advantages would inure to the benefit of consumers in terms of a carrier's ability to introduce a wider selection of more innovative and competitive offerings. Simply stated, a choice for insurers translates to more choices for consumers.

Our economy thrives on competition and on the entrepreneurial spirit that has brought innovative and exceptional products to the market. Much work has been accomplished by states toward uniformity and consistency under the direction of the National Association of Insurance Commissioners (NAIC). The NAIC is to be commended for its leadership and its resolve. But, the process proceeds at what some observers have characterized as glacial speed, the victim of the continuing resistance by some states to accept alternative applications of regulatory concepts and regulatory priorities in conflict with their own. Without an impelling incentive, the process of crafting meaningful regulatory modernization among the states can be expected to continue to move slowly. Can we afford to wait and risk the consequences? There are compelling reasons to act now:

- An expanding global economy demands a unified approach to our participation in the international insurance arena.

- Our complex and overburdened legal system strains to serve an increasingly litigious society, pressuring an insurance industry disadvantaged by the inconsistent rules and regulations under which it must operate.

- The option of employing the internet to make viable insurance products available to consumers via e-commerce demands uniform insurance laws and the immediacy of consistent interpretation enabled by federal regulation.

- Federal initiatives, such as the "Patients' Bill of Rights" and the potential impact on Workers' Compensation coverage of pending HHS medical privacy rules are examples of issues that bolster

arguments for considering centralized versus de-centralized regulatory authority in certain circumstances.

- The insurance industry acted with dispatch in response to the September 11th tragedy. A critical component of our preparedness and resolve to deal with the far-reaching and extraordinary challenges of possible further terrorism events illustrates the key role of the federal government. Stakeholders did not approach fifty states for a solution to terrorism insurance, they went directly to Washington.

This is not to say, as some critics would suggest, that it is necessary to "reinvent the wheel" to shift from exclusively state regulation to a system that introduces a federal component. Providing the insurance industry with a strong voice in Washington is not intended to either replicate or replace all state regulatory authority. Ideally, federal and state regulatory authority would be neither exclusionary nor duplicative but simultaneous and complementary.

Where to look for the components of federal regulation is obvious: the best practices of the state regulatory system. Discussions aimed at achieving uniformity among states default to best practices considerations in crafting model laws intended to encourage uniformity. But, **encouraging** it is not the same as **requiring** it! The creation of appropriate federal policies, based on existing state model laws, coupled with the creation of appropriate new federal policies, would require the broadest and most immediate application of such policies. A federal regulator would have the tools to make it happen.

The Founding Fathers were judicious in crafting a federal umbrella that would not impair states' rights. Their goal was to strengthen a system of individual state mandates by bringing structure and unity. More than two centuries later, we struggle with this concept in terms of its application to the regulation of insurance – a mechanism that the tragedy of September 11th confirmed is critical to our economy and to our lives.