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Track: Financial Reporting
Moderator: MARK D. PEAVY
Panelists: MIKE PICKENS†
THERESE M. VAUGHAN

Summary: Various projects are underway at the NAIC to enhance the efficiency of state regulation. Among these projects are: efforts to create an interstate insurance compact, more uniform requirements for agent and company licensing and better coordinated requirements for forms and rate filings, in addition to other initiatives that are underway. Attendees receive updates regarding NAIC activities relative to these projects.

MR. MARK D. PEAVY: I'm the NAIC life and health actuary; and this morning I think we have a little bit different, but very interesting, session for you.

Generally at these sessions, when we talk about NAIC activities, it's something about XXX or XYZ or some other awful permutation of the alphabet. But this morning we're going to take a little bit broader perspective. We have two excellent speakers—the current president of the NAIC and the past president of the NAIC.

Our first speaker is going to be Commissioner Mike Pickens from Arkansas, who is going to talk about a broad range of activities underway at the NAIC. After Commissioner Pickens, Terry Vaughan, the commissioner from Iowa and the past president of the NAIC, is going to talk about a very big project underway at the NAIC, the Interstate Insurance Compact.

The way the morning is envisioned to go is that the formal presentations will last for about half the time, leaving plenty of time for you in the audience to raise any questions you'd like to our speakers; so this is your opportunity. If you've ever had a question about state regulation, now is your time to ask.

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† Mr. Mike Pickens, not a member of the sponsoring organizations, is Commissioner, Arkansas Department of Insurance, Little Rock, Arkansas.

Our first speaker, as I mentioned, is Mike Pickens. Mike was appointed as Arkansas insurance commissioner on Jan. 15, 1997. Commissioner Pickens is currently serving as president of the NAIC. Prior to assuming the insurance commissioner's post, Commissioner Pickens was a partner in the Little Rock law firm of Friday, Eldredge and Clark, where he practiced in the area of insurance defense, representing policyholders in personal injury and worker's compensation litigation.

Commissioner Pickens also maintained a small family law caseload while working at the Friday firm. He graduated from the University of Mississippi with a B.A. in English and an emphasis in premedicine curriculum. Also, Commissioner Pickens is a graduate of the University of Arkansas, Little Rock School of Law. In his capacity as state insurance commissioner, Commissioner Pickens is a member of insurance-related committees throughout state government. During his tenure, the Arkansas Insurance Department was identified as one of the nation's most progressive insurance regulatory agencies by A.M. Best. Commissioner Pickens is going to speak this morning on the broad range of activities underway at the NAIC.

MR. MIKE PICKENS: On behalf of the NAIC and the State of Arkansas, thank you so much for allowing Arkansas and Iowa and the NAIC to be a part of your meeting.

From the activity that's going on out in the hall, it looks like you all are very, very busy, and I appreciate you choosing this little forum this morning to come in here and to listen to the regulators. What I'm going to try to give you is maybe a 20,000-foot view, because as a lawyer that's about all I'm capable of giving you. Terry and Mark are the actuaries, and they can probably get into more detail about some things if you'd like to hear that; but I'd like to kind of give you a 20,000 foot view of some projects that are going on at the NAIC. I hope that you'll be impressed—favorably impressed—with all the work that's going on in our organization.

Actuaries are a very large part of our work at the NAIC. As you know, we work closely with the Society; we work closely with the Academy. My favorite actuary happens to be John Hartnedy, my deputy commissioner in Arkansas. I don't know if any of you know John, but John is a life and health actuary and is a good friend and confidante and counselor and helps me make, I hope, some good decisions in the life and health area.

Before I get into my presentation though, I think Terry can tell you that as NAIC president, it seems like you spend a lot of your time in an airplane. Very little of your time, it seems, is spent at a podium visiting with people. Most of your time is traveling, and I'm sure many of you can appreciate that, too.

I try to keep up with things while I'm on the airplane. I want to kind of be up when I get to different places. I try to keep up with popular cultures so every once in a while I'll pick up a *People* magazine or something like that. I happened to pick up

one a month or so ago, and this has absolutely nothing to do with insurance, but I want to read it because I thought it was kind of funny.

It appears that Steve Martin, the comedian, was named one of *People's* 2003 "50 most beautiful people." They ask all the people that receive this recognition to make a little comment about what it meant to them; you can imagine what Steve Martin said. As I read this, try to read into it Steve Martin's amount of cynicism and mockery and things of that nature.

Upon being presented this honor, Mr. Martin said, "It's very hard being one of the most beautiful people. Having this kind of beauty is actually quite a burden. Sometimes I go to a party and not one of the other 49 most beautiful people is there. That makes me feel very solitary and alone, because it means I am the most beautiful person in the room.

"If I'm going to a party where I know there will be less beautiful people, I always try to dress down in order to hide my beauty, but this actually seems to have the counter-effect of making me much more beautiful. I guess me and a pair of dungarees are a pretty potent combination.

"I try not to lord my beauty over others, but again, this is very hard. I try not to mention that I am one of the most beautiful people, but somehow it always comes out in a conversation. I will usually only bring it up when I'm asked to do a task like open a garage door. People seem to enjoy my beauty and are genuinely happy for me, because after I mention that I am one of the most beautiful people, they always say, 'How nice for you.'"

When I tell people I am the current NAIC president back home, they say, "How nice for you," so I guess that is a segue into my presentation this morning.

Since the passage of Gramm-Leach-Bliley in November 1999, state insurance regulators really have been closely scrutinized by Congress. We have been, to some extent, put under the gun to make our insurance laws and our regulatory activities across the country more uniform, more coordinated and more consistent from state to state. Gramm-Leach-Bliley required that by November 2002, at least 29 states had to pass uniform or reciprocal-producer licensing laws. It required states to pass privacy laws or regulations to protect the personal financial information of consumers, and I'm happy to report that we have made tremendous progress in those areas.

Forty-eight states, the District of Columbia and Guam have passed a version of the NAIC Producer Licensing Model Act, and the NAIC actually has certified that 38 states are Gramm-Leach-Bliley-compliant, at least those are the last numbers I have. Terry and Mark may have more current numbers. But I have 38 states, and 29 were required; so I think for all the criticism of the NAIC standing for things like

"no action is contemplated," over the last three to four years, I think we have broken that mold and really shown tremendous progress.

All states and the District of Columbia have passed privacy regulations. All of them have passed laws protecting personal financial information, and some of them have even gone a step further to provide a higher degree of protection for personal health information. So we have met, we believe, the Gramm-Leach-Bliley requirements, the specific requirements that were set forth in the law. We have a lot of other projects all geared toward making insurance regulation more uniform; making it more consistent; coordinating our activities among the states; and doing a better, more effective job of protecting consumers, while at the same time trying to make our regulation less costly and less burdensome on the companies that we regulate. The clear message from Congress has been that the emerging financial services marketplace is important to our economy, and it's important to consumers. They believe that the free market should pretty much run unhampered, but they also recognize that in an area like insurance, there needs to be a good, reasonable degree of regulation and that our job is to protect consumers.

They want us to do that. And at the same time, they don't want us to hinder the development of these emerging markets.

Gramm-Leach-Bliley has also brought about a renewed cry for possibly the creation of a federal regulator of the business of insurance. I don't have to tell you as a state insurance commissioner, I think you know what my position would be. I believe that state insurance regulators are much closer to their consumers in ideology and in proximity. I believe that when a consumer wants to call 911, he wants that call to be a local call. If he needs help with an insurance problem, he doesn't want to have to call some huge distant bureaucracy in Washington, D.C. He'd like to be able to rattle somebody's cage in Des Moines or in Little Rock or in any other of our state capitals. So I am a very strong believer in state regulation of the business of insurance.

I believe—and I think I speak for practically all our NAIC members, if not all of them—when I say this: we all do strongly support state regulation. We recognize that there are some areas of state regulation that need to be modernized; we're working on those and we'll talk about some of our projects here in just a second. But at the same time the state system has served consumers well for 150 years.

The state system has been good for consumers. It's been good for companies. It's been good for agents, and it's worked well for our state governments. Our state governments rely on the premium tax revenue that is generated by the regulation of insurance companies in the states and the other fees and assessments, so we have an entrenched system of state regulation out there. I think it would be a mistake to throw out the baby with the bath water, just because we perhaps have some problems in certain areas—producer licensing, speed to market—with a limited number of states because of local political challenges. I think it would be a

big mistake to throw out state regulation in favor of a federal regulator that I don't think would be nearly as responsive to consumers or as accountable to the voters as state regulators are.

I know that's not surprising, but that's pretty much the perspective I have on this entire debate. I have to tell you, as long as state insurance regulators do a good job of protecting insurance consumers, I think that state regulation will be just fine. When people talk about the market driving change, to me, the market is consumers—it's what consumers want, it's what consumers expect from companies and their regulators. And as long as we keep our customers happy and our customers are our fellow insurance consumers, then state insurance regulation will do just fine.

This year our projects fall into three main areas. The first one, obviously, is consumer protection. The second one is insurer regulation. The last one is speed to market, and I'll touch briefly on some of these. Speed to market also includes the Interstate Compact, which Terry Vaughn has been a strong proponent of at the NAIC. It passed overwhelmingly last year at the NAIC due to Terry's leadership. That interstate compact is for life insurance products, annuities/disabilities products and long-term-care products.

Consumers and the NAIC

At the NAIC, we have something for consumers called the Consumer Information Source (CIS). Really, it's a Web site at the NAIC. You can go to the NAIC Web site, www.naic.org; you can click on Consumer Information Source, CIS; and if you're a consumer, you can find out how to file a complaint with your state insurance department. You can find out a little bit about a company that you're thinking about doing business with or one that you're already doing business with. You can get some basic financial information about that company. You can find out if they've had any problems that you as a consumer might want to be aware of. This is the purpose of the CIS database. As insurance regulators, we can do a lot to protect consumers; and obviously we do that through financial solvency, market conduct, regulation, fraud, prosecution and deterrents of fraudulent activity. But at the same time, who is in the very best position to protect an insurance consumer? The consumer is: I am.

But if I'm a consumer, and I'm going to protect myself, I have to understand some things. I have to know about the company that I'm doing business with, I have to understand the product that I've either purchased or I'm thinking about purchasing. As all of you know, even sometimes folks like us, who are relatively sophisticated insurance consumers, have some questions about insurance company practices and products and things of that nature. So the purpose of the CIS is to try to educate insurance consumers, to give them a fundamental understanding of the financial condition of the company, of the products that they're purchasing and give them an

opportunity to determine whether a product they're thinking about purchasing is suitable for them.

Information is power. It's an old cliché, but it's true. And if we can give consumers information, they are there all the time; and they can protect themselves better than any insurance regulator can. That's the purpose of this consumer information source. At the NAIC we're constantly updating the financial information, the complaint information that's in that database and looking at ways to improve that database to give consumers the best and most accurate information that we can possibly give them.

Market Conduct Exams

Another important area of focus at the NAIC this year is going to be market conduct examinations. We had a hearing a couple of weeks ago at which Joe Ario, our secretary/treasurer, and the Oregon superintendent of insurance testified in front of Congress, updating them on what we've done in the area of market conduct.

In some of the preliminary statements that were made before the witnesses were allowed to testify, the Financial Services Subcommittee made it very clear that market conduct is an area in which they believe the states need improvement. They would like to see us conduct more coordinated, targeted market conduct examinations—examinations that are more effective from the consumer protection standpoint and that are less costly and less burdensome on companies.

For those of you who don't work within an insurance department, how many of you have been involved in one way or another with a market conduct examination from the perspective of the examinee? There is one. Was it a pleasant experience? Maybe not as bad as a proctological examination, but I've heard some people say it equates to that.

One of the things that, even as a regulator, I have trouble understanding is: We basically have the same issue pop up in several states. It will pop up in one state first. We start talking about it at the NAIC, and we can communicate in real time now. Commissioners all are hooked up by e-mail; we can talk to each other every day.

As the same issue pops up in two or five or 15 states, you end up with 10—and in some cases, 20—different market conduct examinations, different state examiners basically in the same company on the same issue. That doesn't make a lot of sense to me. It doesn't make a lot of sense to me as a regulator; so our approach at the NAIC really is to develop best practices so that we can determine when it's appropriate and necessary to call a market conduct examination and then best practices as to how we conduct that examination once we've called it.

If a number of states have a problem, then we need to follow a lead-state-type approach, in which one state will act as the lead state. It certainly would make sense that the domestic regulator act as the lead state. Other insurance departments could either actively or passively participate in that market conduct examination. And that way the state insurance departments could go in as a team, at one time, and deal with any issue they had to deal with. Everybody would be able to share information and share the results of the examination. They could get information about consumers in their individual states, and certainly it seems to make sense that that would be a good way to conduct a market conduct examination that's effective from the consumer protection standpoint, but one that is not overly burdensome and overly costly to the companies who end up paying for it. That's our goal at the NAIC, and that's what Joel was testifying about in Congress a couple of weeks ago.

NAIC 2003 Market Conduct Goals

We also have some specific goals under the market conduct area, and I'd like to zip these off if I could.

In 2003, we'd like to get 40 states to certify compliance with all four areas of exam uniformity (exam scheduling, pre-exam planning, exam procedures and exam reports) and also to develop a process for resolving complaints about certifications. We want to get 15 states to sign the reciprocity agreement—this is our interstate collaboration agreement—and define baseline responsibilities for the domestic state regulator when it comes to conducting a market conduct exam.

We want to publish a market analysis guide with instructions for using complaint data, financial data and market share information to target the most significant market problems.

And that points out another problem that we sometimes have. Sometimes we focus on a market conduct issue that is not all that important. So we want to do a better job of prioritizing and using our resources to the best interests of our consumers and to make our exams as effective as possible.

We want to complete an annual statement pilot project for life and P&C companies and assess long-term viability of our annual statement approach, and then we want to resolve three significant interstate market problems through our market analysis working group (MAWG). All of you are probably familiar with the financial analysis working group (FAWG); well now we have MAWG at the NAIC, the market analysis working group. MAWG will help us to coordinate our market conduct activities.

NAIC Global Receivership Database

In the area of insurer regulation, we're going to initiate a range of programs this year, as well.

One of the programs that is near and dear to my heart this year is one that Holly Bakke on our Insolvency Subcommittee and Chuck Cohen, the chair and co-chair of that Insolvency Subcommittee, are heading up at this time. That's our global receivership database.

Especially those of you who are P&C folks will be familiar with some of the insolvencies that we've endured the last few years. Many of them—practically all of them that I can think of—have affected consumers across state borders. When Reliance went down, for example, in Pennsylvania, we had consumers in Arkansas that were affected. Legion and Villanova had consumers in Arkansas that were affected; and all over the country consumers were affected.

In a case like that, our guarantee funds and our insurance departments and our deputy receivers really need to be able to have all the information that they need at their fingertips to be prepared to pay those claims when the court issues an order determining that the company is insolvent. Our guarantee associations all have organizations that work well together, and they're pretty much in the same mode that we are at the NAIC now—trying to coordinate their activities.

We believe in the creation of a global receivership database that would be accessible by all state regulators and guarantee associations. We're talking about creating this database right now. We're talking about what kind of information should go into the database—number of policyholders that a company has in a given state is something obvious, policy limits—all types of data that might go into this global receivership database. Holly's committee is talking about what information should go in it and who should have access to it.

To overly simplify, perhaps, the ultimate goal is that we want state insurance departments, deputy receivers and the guarantee associations to have all the information that they need when a court issues an order of insolvency. We should be ready to pay claims so that consumers see pretty much a seamless transition from a going concern to a company now that is being run off through the court system. That's the purpose of this global receivership database.

It is important, because that's one time, when a company becomes insolvent, that consumers have a lot of questions and confusion. Is my claim going to be paid? I have a claim that is in excess of \$100,000 or \$300,000—am I going to have to bear part of the responsibility? What's going on here? To the extent that we can address their concerns on a real-time basis and really help them through this tough period, I think we're focusing on our consumer protection responsibilities; and that's why this global receivership database is so important to us at the NAIC.

National Treatment, Coordination Initiative

We also have a national treatment and coordination initiative that will bring about greater consistency to our corporate governance and procedures for amending a certificate of authority. Later this year, our national treatment and coordination working group will conduct a corporate reorganization pilot project focusing on the regulatory requirements involved after an approved merger or acquisition of multiple insurers.

Speed-to-Market Concerns

Speed to market is an area in which Congress really has placed a great deal of scrutiny on state regulators in the past few years. That is, the proponents of the federal insurance charter argue that if I'm an insurance company doing business on a multi-state basis, I have to go to each and every state and comply with a number of different rules and regulations and laws to get my rates and forms approved. It takes forever in some cases, and that is a big criticism of state insurance regulation.

That's one of the primary criticisms that's driving the call for a federal regulator. Congress is listening to the insurers, and they're placing a great deal of scrutiny on us. So they want to know what we've done in the area of speed to market. I can tell you, we have made a great deal of progress in the last three or four years in the area of speed to market. We have a system—a single point of filing, single point of review system—called SERF, the system for electronic rate and form filing. I was visiting with some of our folks in Kansas City, and they were telling me that roughly 10,000 filings came through the SERF system in April, and the average turnaround time for those filings was 17 days. If that's not speed to market, folks, I don't know what is.

But our challenge at the NAIC is going to be to try to get more states to accept more lines through the SERF process; because right now, some states accept all lines. Iowa does, Arkansas does, and a number of other states do. But we have some fairly significant states out there that as of yet don't accept all lines for SERF, and that's a problem. We need to encourage those states to get online, so that insurers can make these filings. SERF accepts P&C filings and life and health filings across the board.

We also have developed at the NAIC a checklist. If an insurer wants to file in 15 states, they can go to the NAIC Web site; they can click on the appropriate part of that Web site; and they can pull up a checklist that will tell them what requirements are necessary to file a rate or a form filing in individual states. They can look at Arkansas and see what our requirements are. They can look at Iowa, at California, whatever. This checklist is intended to help them make the filing correctly the first

time they file it. Sometimes it can take months before a filing is finally correct and ready to be reviewed and approved. We have made a lot of progress there.

The Interstate Compact

The interstate compact will be a great boon for life insurance and annuity products. It's a win-win-win for consumers, for the industry and for state regulators. And we're really pushing that at the NAIC.

We're in the process now of developing national product standards, and we also are working with the National Conference of Insurance Litigators (NCOIL) and the National Conference of State Legislatures (NCSL) to get their endorsement of this interstate compact. As you know, an interstate compact has to be introduced and passed by legislatures to become effective. Iowa already has passed its compact this year. So hopefully this will send a strong signal to other legislatures that the compact can work and that it's something of which they need to be cognizant.

Working with World Markets

A lot of other things are going on at the NAIC. We have people in our organization who have been very active in working with foreign insurance regulators through the various committees and world organizations. One of those is the International Association of Insurance Supervisors (IAIS), which is kind of like the NAIC for the world, in which you have insurance supervisors from all over the country that participate. Their goal is uniformity and consistency of world laws, of accounting standards and enforcement of insurance regulations across the world.

We work constantly with the Office of Economic Cooperation and Development (OECD), which is a Paris-based group. One of the things we're working on there is the development of international accounting standards. When European companies come over here to do business, we, as American regulators, want to be able to take a look at their financial statements and understand them. We need to know that we're looking at apples and apples when comparing financial data from European and American companies.

We have worked with governments in China, Vietnam, various Latin American governments and Egypt to help them as they are developing insurance laws to regulate their emerging markets. These countries now are starting to develop middle classes that have disposable income. These folks are looking for a way to protect their assets, ways to invest their money, and insurance is a big part of that picture.

These countries now are looking to the United States: "How do you all regulate the financial services industry?" The NAIC has been working with the State Department, the Commerce Department and these world organizations that I mentioned to help

these governments as they learn about how to regulate these new emerging markets in their countries.

Health Insurance

One of the most important things that we focused on at the NAIC this year is health insurance. I bet the number-one complaint we get in our states is that health insurance costs too much, and people can't afford it. How many life and health actuaries do we have out there? There are a few. Well, you all need to tell us how to fix this problem.

All of us know that this is a big problem, but this year I really thought it was important that we focused on the cost of health insurance. We have increasing medical costs. We have the increasing cost of pharmaceuticals, and we have increasing utilization. These are the primary drivers of health insurance costs. But I also suspect that we as regulators have made some mistakes in some areas. I don't know that for sure, but I think it's something we need to look at. Portability has been a good thing, and it's not very costly. But when you talk about guaranteed issue, I wonder if guaranteed issue really has accomplished the objectives that we'd like to see it accomplish.

I know that in our state, our small-group rates have gone through the roof. I don't know if that's a result of the small group reforms of the late '80s and early '90s or not. Perhaps we need to consider tweaking those small-group reform laws. I really don't know what the answer is. I know that individual states may have focused on this problem, but as a group, the NAIC really has not focused on it. But this year we are focusing on the problem and hopefully will come up with some answers.

Depending on what statistics you look at, we have around 41 million uninsured people in this country. That's a lot of people. If you consider the people who were without insurance for a period of time, anywhere from six months to a year, that number can get as high as 60 million to 75 million, when we had Americans unable to purchase health insurance coverage. That's a big problem.

Here are some of the questions we're looking at at the NAIC. What has been the effect of the federal government's expansion of the Employee Retirement Income Security Act (ERISA) on the health insurance marketplace and consumers? What has been the effect of guaranteed issue and our small group reforms on the health insurance marketplace? What are the costs versus the benefits of various coverage mandates? Should Congress allow the free market to work and make medical savings accounts (MSAs) more attractive to more people? Should they be willing to give individual insurance consumers the same tax breaks that they give to businesses? Should they give consumers tax credits, if they commit to use that money to purchase some degree of health insurance coverage?

In the long run, what can we do to hold down these primary drivers of the cost of health insurance? Utilization and a healthy lifestyle certainly come to mind, but there's only so much you can do there, as all of you know.

The cost of medical and pharmaceutical treatment is an issue. We're in a transition period right now, where with molecular medicine and other technological advancements, we're developing pharmaceuticals and better medical treatments. Hopefully, at some point in time, that will actually bring down the cost of medical care and pharmaceuticals. I think it should, and I think if it doesn't, we should ask some hard questions of the companies that have developed these treatments.

We've done what I would refer to as experimentation with various degrees of socialized medicine in this country. We've had a great deal of regulation. We seem to believe that we can regulate lower costs. And I wonder if some of our regulations would not, in fact, have the opposite effect. Again, I don't know the answer to that question; but we have some of the best minds in the country at the NAIC looking at that issue right now.

I would like to see us give the free market a chance. I think if we turned it loose, it may work; but I surely don't see that it could hurt. Our comprehensive health insurance pool in our state for high-risk individuals has exploded. The population has exploded, and cost has exploded. In our small group market, many small companies cannot afford health insurance anymore, and we hear from them constantly. That's forcing them into the individual market, and it's very hard to find affordable health insurance in the individual market. We have to do something, and I think it's time we focused on this area. The NAIC this year has been working with a number of groups, the Milbank Foundation being one of those. Hopefully we're on the cusp of finding some solutions to this health insurance problem, and I hope that by giving national attention to this issue this year that we'll make some real progress.

I'll look forward to answering your questions in a minute. Thank you.

MR. PEAVY: Thank you, Mike. Our next speaker is Terry Vaughan. Terry became Iowa insurance commissioner on Aug. 1, 1994. She is the immediate past president of the NAIC. Before becoming insurance commissioner, she was the director of the insurance center and chair of the insurance department at Drake University. Before joining Drake, Commissioner Vaughn was a consultant in the risk management and casualty division at Tillinghast. She also held previous academic positions at Baruch College of the City University of New York and at Temple University.

Among other accomplishments as commissioner in Iowa, she was responsible for implementing the 1995 Individual Health Insurance Reform Law and for implementing the mutual insurance holding company statute. She earned a Ph.D. in risk and insurance at the Wharton School of the University of Pennsylvania and a B.B.A. in insurance and economics at the University of Iowa. She is a CPCU, an

associate of the Society of Actuaries, an associate of the Casualty Actuarial Society and a member of the American Academy of Actuaries. Commissioner Vaughn is going to speak this morning on a project that she has played a leading role in at the NAIC, the creation of an interstate insurance compact.

MS. THERESE M. VAUGHAN: Good morning, everyone. I get to talk to you, as Mark said, about the interstate compact this morning. The Interstate Compact is specifically focused on life insurance, annuities, disability income and long-term care. I always find it helpful to start this discussion by providing a little bit of background on why this is a different solution for the life insurance side of the industry as opposed to the P&C side.

We talk about the insurance industry, but the insurance industry is really a very complex industry with many different facets. Life is very different from P&C; it's very different from health. We have different actuarial organizations in life and P&C. We have different financial statements. We have different risk-based-capital systems. We have different reporting systems and so forth; and so there are a lot of differences, and they face different issues and different challenges.

This colors their view of the problems they have with state regulation and the improvements that are needed. It really hit home for me last June when the House Financial Services Committee had a series of three hearings over three weeks on insurance regulation—the optional federal charter, what are the problems and what are the proposed solutions.

It was fascinating, because they had a parade of people that came in and spoke from the P&C and life insurance industries. There was a lot of talk about uniformity. Some said the problem with state regulation is that the states are too different.

The P&C companies, for the most part, came in and said, "We are not looking for uniformity; that's not our problem. In fact, we don't think uniformity makes sense. We don't think it's achievable. We have different tort laws in the different states. You have no-fault auto in some states and not in others. You have earthquakes in some states and hurricanes in other states. We don't think uniformity is the right goal for P&C insurance.

"We do think, however, that we have a real problem with our system of rate and form regulation. We're overburdened with rate regulation. You ought to let the competitive market do its thing." And that was their main message.

The life insurers came in with a very different message. They said, "We are facing competition from banks."

Joe Gasper, COO of Nationwide Financial Services, testified that they wanted to bring a product to market nationally, a single product. They had to file 35 or 38 different state-specific forms to bring this one product to market. They had two

forms in one state that they had to file. It's expensive, and it's time consuming. They can't come out with a national advertising campaign because of these different standards in the states. It takes them longer to get the products approved. So they said, "We need uniformity. We need a national market; we need to be able to operate in a national market."

When you think about this, it makes sense. We have very different markets. Life insurance companies do operate in a national market. They deal with mortality risk and interest-rate risk. They don't deal with the kinds of differences that the P&C companies deal with. They issue long-term products. Consumers move from state to state, and they're competing nationally in a market with other financial services providers.

The commissioners, in talking about this, recognized that and agreed. This industry is operating in a national market, and we need to find a way to regulate this nationally. In fact, the statement of intent, which was adopted in March 2003, actually has a sentence in it that says, "We recognize that certain aspects of the industry deserve a national system of regulation." It doesn't say a federal system of regulation—that's different. But it did say a *national* system of regulation. We recognize that certain aspects of the industry deserve that.

Then it goes on to talk about a single point of filing for products where that makes sense. What we had in the back of our minds, although we didn't say it in the statement of intent, was life insurance products.

Details of Interstate Compact

What I'm going to talk about here is the Interstate Compact. We're going to talk about how this proposal came about, some backgrounds on compacts—what are compacts, what do they do—and then some highlights of the current compact, frequently asked questions and then the timetable for action.

Origin. Where did it come from? Well, it came from the recognition that this marketplace is changing; that the life industry is facing much more competition from other sectors of the industry; that we have increased mobility of the population. We have people that move from state to state and ask questions, "Does it really make sense to have different standards in different states?" There is a recognition that the risks that are borne really don't have local characteristics, and so the industry would issue national products were it not for these deviations that exist because the way the states have grown up. Therefore, a single point of filing with uniform standards makes sense for the life side of the industry.

Why is this good? I like to say this is a win-win-win for insurance regulators, for the insurance industry and for consumers. Clearly the industry is demanding something like this to solve the problems in bringing its products to market; but it's good for consumers and it's good for regulators, too.

Currently we have essentially the same products that are being filed across the country, with minor differences to reflect these specific state requirements. And we're all going through our own reviews of those products, and we're all doing reviews of thousands and thousands of products a year. It's not a very efficient way to allocate our resources, and we can do a better job of taking these limited regulatory resources—doing a single really good review, which we need to do because these products are getting more and more complex.

We can get better expertise. We can centralize the expertise. We can do one high-quality review and do a better job of protecting consumers and of knowing what it is that the companies are doing.

We can leverage the collective expertise of the states when we're setting uniform standards so that we have a good set of national standards. We can free up resources to do other things—something that everybody needs to do these days with the resource challenges we have. We address the industry's desire for a single form of filing, and we respond to the increased mobility of the population.

The compact was an outgrowth of the Coordinated Advertising, Rate and Form Review Authority (CARFRA). Our first attempt to solve this problem, following the statement of intent, was to create CARFRA. We said, "Here's what we'll do: We will create something in which the states collaborate in reviewing products. We'll develop some national standards, and then the states will go through and amend their laws and their regs to conform with those national standards so we all have the same standards. And then we'll have a cooperative review process."

That sounded like a good idea, and so we proceeded. We identified three products; we got 10 states to participate in the pilot; we developed product standards for those three products; and we rolled this thing out in May 2001. Great fanfare—OK, CARFRA is now open for business. Everybody come file your products with us; we're going to do these reviews.

We got a filing in June, and we reviewed that filing. They did it, I think, in 30 days and announced that they've approved their first CARFRA filing. We were ready to go. And we waited, and we waited, and we waited and we waited. And we did not get any more filings. We headed into fall 2001 asking the industry, "What is going on here? What's the problem? Why aren't you guys using this?" And the industry said, "Because it doesn't solve our problem. You have a coordinated review and you have some national standards, in theory; but you haven't gotten rid of the deviations. Every state has deviations from those national standards, and some states have literally hundreds of deviations; so it doesn't get us anywhere. We still have to have different state-specific products."

The lesson that we learned was that we had those state variations. Now we head into the Commissioners Conference in February 2002. You guys don't realize how hard insurance regulators really are working to solve this problem. We're really

thinking, "How can we do this? Recognizing we're a state system, we have to work through state legislators; we have to work together."

We spent a full day, maybe longer, at the Commissioner's Conference just brainstorming about what the problem is here and how can we solve it. We concluded that we have to find a way to get to uniform national standards. We have to find a way where we have the ability for a company to file a product and be subject to the same standards in all the states.

How do you do that? Well, we formed a working group in February at the Commissioner's Conference. We said, "Go back; look at this and figure out how we can get this done." They came back to us in March and they said, "The way that you do this, the way you solve a problem like this, is through something called an interstate compact."

Definition. What is an interstate compact? An interstate compact is something that's referenced in the Constitution, and it is essentially a way to solve multistate problems at the state-based level.

There are two ways you can solve multistate problems: You can go to Congress and ask them to solve it, or you can solve it yourself. An interstate compact is the way you solve it yourself. It's basically a treaty among states. One state passes a law, and the other state enacts the law, just like you would do treaties on the international level.

It's historically been used for things like border disputes and water rights between states. It goes back to the forming of this country. The first compacts were back in the 1770s or 1780s. But in recent years, as we have had this kind of increased interest in the concept of federalism and trying to find state-based solutions, we are seeing compacts used more and more in other areas. The issue of driver's licenses is one where a compact has been around for decades. The reason that your driver's license works in multiple states is because there is a compact that all 50 states have joined that says, "We recognize each other's driver's licenses." There are compacts in environmental issues, emergency management, taxation, adoption laws and so forth. There are more than 200 in existence and every state belongs to at least 14.

When we were looking at an interstate compact in life insurance, we stumbled across something that is currently in the works in the states that really, for me, helped me come to the conclusion that this is the right answer.

Here's the deal: Internet sales are growing. We have businesses selling more and more over the Internet, and the states are very worried about the loss of sales tax revenues from these Internet sales. They want to be able to tax sales over the Internet.

The businesses that are selling over the Internet went to Congress and said, "We can't possibly do this, because every state has different sales tax regimens. They have not only different rates, they have different definitions in what's taxable and what's not taxable. Orange juice is a drink in one state, and it's a fruit in another state, and they have different tax systems." So Congress put a moratorium on the taxation of sales over the Internet. They said to the states, "You go fix this problem, because if you can't find a way to get to uniformity, then we're going to preempt your ability to tax Internet sales permanently."

You can imagine this really grabbed the attention of the governors and the state legislators. When it comes down to hard dollars, that really gets their attention. And so they had this intensive effort to solve this problem. They worked over a couple of years to come to a solution. They reached the same conclusion we did. The way you solve this problem is by creating an interstate compact for Internet sales. They drafted the compact, and they're in the process now of going through the states and getting it adopted.

Governor Mike Leavitt of Utah is one of the big proponents of the multistate tax system. I think he might have been the president of the National Governors' Association (NGA) at the time or the chair of the NGA at the time that it endorsed it. I love this quote, because he says, "It's not just about sales taxes; it's about a new frontier of federalism. It's about a way for states to solve problems collectively instead of looking to the federal government to solve their problems." The Council of State Governments (CSG) has been active in a number of compacts. We have an individual here who talks about their being the only tool that's truly adequate for addressing multistate issues.

Nuts and Bolts. How does our compact work?

Well, our compact, the Interstate Insurance Product Regulation Compact, would be created by having states enact the enabling legislation. We drafted the model legislation and we adopted it at the NAIC in December. The member states that are in the compact would develop the uniform standards collectively for the products that can be filed with the commission.

Say we had developed a standard for individual term life insurance. Once it's been adopted, the state can decide, "We don't think that those standards are right for us," and they can go through a process of opting out. (I'll talk about how that happens in a couple of minutes.) But when a state does not opt out, when they stay in, then those standards have the full force and effect of law in that state; they replace all other standards for products that are filed with the commission. And approval of the product by the compact commission has the full force and effect of law in the state.

It's important to know that this is an optional system. It's kind of our version of an optional federal charter, I think. It's optional because a company can file through the state, or they can file with the compact.

We'll talk about the following issues here, and I think this presentation is on the Web site of the Society of Actuaries. We'll talk about the products, uniform standards and so forth. In the interests of time, I will run through it quickly.

Products. You've already heard that the products include life insurance, annuities, disability income and long-term-care insurance. Long-term-care insurance is optional for the state. A state can join the compact without being a member for purposes of long-term care. But if you join the compact, you will be in the compact for life insurance, annuities and disability income.

Uniform Standards. The standards are developed by the members of the compact—the states in the compact. We envision that this will be a process that will be led by state insurance regulators. A state can appoint someone other than the insurance regulators to the commission, but I would have a hard time imagining that states will be doing that.

We will conduct our rule-making process through the process that you would ordinarily see in the states now. We, in the compact, state that we will follow the model State Administrative Procedures Act; so there will be notice and public hearing in the rule making and so forth.

The approval of a set of product standards requires two-thirds of the management committee and two-thirds of all of the commission members. This management committee was one of the things we spent the most time on. As I said, the states can opt out.

Advertising. Advertising also is covered by the compact, because the companies want to be able to bring a single product to market nationally, and they want to be able to advertise that product nationally—and different advertising standards in the states can create a problem.

For long-term-care insurance, because a number of states currently have prior approval requirements for advertising of long-term care, the commission can have prior approval requirements for long-term care. For the other products, it's simply developing the standards, but we don't have a prior approval system—which is consistent with what the states currently do.

Central Point of Filing. The central point of filing works this way: When we have a compact, we have a commission. We are going to have the products filed with this compact. Then once we have the standards approved, the compact could be staffed by full-time employees of the compact. We also could use employees of the state

insurance departments on a borrowed basis, or they could do the work. This activity is overseen from a governance perspective by a management committee.

Governance. Governance was an issue we spent an enormous amount of time on, because we basically got into a lot of discussion about big states and little states. It was sort of like the Constitutional Convention—what's the role of the big states, what's the role of the little states? Has anybody read the book Founding Brothers? It's a fascinating book. It talks about the fathers of the country, and I was reading the book at the same time we were going through this compact discussion. I thought, "Gee, does this ring bells."

The management committee was a compromise that was reached to reflect the need to give the large states a little more of a say. The management committee really recognizes economic power of the states. The management committee is structured so that the six largest states—Illinois, New York, Florida, California, Pennsylvania and Texas—which have about 40% of the premium volume nationally in these covered lines get 40% of the seats on the management committee. They get six seats; that's roughly 40%.

We went down to the next tier of states that make up about 30% of the premium volume; we gave them four seats. They vote and elect amongst themselves four members. And then the remaining states, which are about 30% of the premium volume, got four seats. So we have a 14-member management committee, with six of the members being the large states. A standard that's developed has to be adopted by a super-majority of the management committee and then a super-majority of all the states. It's sort of like our version of the House and Senate.

Opting Out. States may opt out of the uniform standard if they do not believe that the uniform standard is appropriate for the state. They can do it by enactment of a law without condition, or they can do it by regulation. If they do it by regulation they have to demonstrate in the process of filing this regulation that the standard doesn't provide reasonable protection to the citizens of the state; and there's language in the compact that talks about recognizing the intent of the legislature to participate in this system of national uniformity and the benefits of the compact.

Individual states will continue to regulate the market activities. There's some language in the compact that allows for coordination between the compact and the commission and the states to determine whether the uniform standards have been violated.

Effective Date. The compact actually becomes legally effective, comes into existence, when two states enact legislation that is essentially identical. The commission becomes operational under the terms of the model legislation when at least 26 states adopt it or states representing 40% of the premium volume adopt it. The fees will be paid by a company's filing.

State Sovereignty. One of the features of a compact that distinguishes it from a federal solution or congressional solution to a multistate problem is that the states stay in control. The states collectively control the compact. A state can withdraw from the compact if it doesn't like what's going on.

In this particular compact, the state has the right to opt out of the uniform standards if it has a problem with it. We provide some oversight by state legislators through regular reports to insurance committees and state legislatures, and we also have a legislative advisory committee that is established under the compact.

It is intended to be an optional filing process. It replaces conflicting state law. There's been some question about whether it might cause some state department personnel to lose their jobs. I have a hard time believing that. I know in Iowa, I can think of a lot things I can use people on, and it does give us an opportunity to do some reallocation to other priority areas. The state-based filing system stays in place for those companies that want to continue to use that.

We do not believe that the compact requires congressional consent. I can go into the legal basis for that, if you would like, a little later during the question-and-answer period.

The Compact Commission is distinct from the NAIC legally. However, the NAIC may be relied upon to provide some technical support, obviously to provide some start-up capital to the extent necessary.

The legislation was adopted by the NAIC in December 2002 for consideration by other state officials. We've been working very closely with NCSL, NCOIL and other groups to try to educate them about the compact and get their support. The NCSL has been looking at the compact in great detail. They've asked us to consider some amendments that really go to more specificity on the openness of the compact.

We had intended to put some of these details in the bylaws—things like open meetings requirements, open records. They've asked that we put that right in the body of the compact, because they think it's going to be more salable to state legislators that way. And so we are probably going to be looking at some amendments to the compact at the June meeting. My expectation is that if we get that done, then we're going to get the support of NCSL and NCOIL.

With those amendments, we'll have a final version of the compact, and we can move forward to the 2004 legislative sessions. Mike said that we adopted a compact in Iowa; that's true. But we did it knowing that there was a good chance that we were going to have to amend it next year; so we're really not in any better shape than any of the other states yet, because we're going to have to go in and make these amendments.

Let me just make a couple of closing comments. We know that regulation is going to change; there's no question. The marketplace has changed, the industry has changed, and regulation is going to change. And the only question is how. What is that new system of regulation going to look like?

The NAIC agrees on the need for this uniform national system of regulation, uniform standards and single point of filing for the life industry. We have proposed this solution that preserves state sovereignty in a way that a federal solution would not. As I said, the state decides whether it joins; the state can withdraw. After the standards are developed, the state can opt out by regulation, and the states control the process. We don't have to go to Washington if we want to change a standard. We can do it ourselves.

This was not a solution that we came to easily. A compact, we recognized, was a real challenge. This is a heavy lift, to get this passed in the states; but it wasn't our first answer. It was the answer we came to after we rejected all other possibilities.

One possibility was to try to go state by state by state and fix all of these deviations. It's not going to work. You're going to get new deviations. You still have the politics of trying to get these things done. Second we could go to Washington and ask Congress to enact uniform standards; and that has its own problems because then when you want to change them, what do you do?

The third alternative was to create a system that we can control, in which we can evolve as we need to in order to meet this changing marketplace. It's a solution that I believe very strongly in, recognizing it's going to be a heavy lift. But it homes in on a very specific problem, and that is the approval of life insurance, annuity, disability income and long-term-care products—that is a very specific targeted problem—while leaving intact all of the other strengths and benefits of the state regulatory system to protect our consumers.

As I said, I believe that it's a win-win-win for insurance regulators, the insurance industry and consumers.

MR. PEAVY: I think the audience has really gotten a good feel this morning in terms of where the NAIC stands in a variety of areas and where it may be going as well.

Now is your opportunity to ask any questions you have. If you do have questions, I invite you to come to the microphone.

MR. DAVID HIPPEN: With regard to the proposed interstate compact and in light of the reference to a number of interstate compacts that are already in existence on various other issues, what do you say to and how do you counter the continual reports that we see that various states attorneys general feel that a state compact would be in violation of their state constitutions, and the appearance that some of

the large states may be counting on that to render the interstate compact impossible so that they don't have to say they don't want to join?

MS. VAUGHAN: I am delighted that you asked that question. I didn't know if I should bring it up or if somebody else was going to bring it up. There's a lot of confusion out there about what exactly the attorneys general have said.

First I want to clarify what has happened. In December, the National Association of Attorneys General (NAAG) issued a letter asking us to delay voting on the compact because they had questions about possible issues (they didn't have the answers, they had questions).

The attorneys general asked us to hold off. We responded that we wanted to go ahead and pass it. We were going to put it out in the public domain, and we were going to work with organizations—CSL, NCOIL, NGA, NAAG, everybody—so that they could raise their issues and raise their possible amendments. And then everybody could come to an agreement on what this thing should look like.

As I told you, NCSL has suggested some amendments. An assistant attorney general from Iowa actually has suggested a proposed amendment that we're going to have a conference call on later this afternoon.

So there is some discussion that is going on.

Subsequently in February, I think, a report was released that was signed onto by three other states that raised questions about the constitutionality of the compact. Actually the report did two things: It raised questions about constitutionality of the compact; and second, it raised public policy questions—is this the right answer? We had looked at all of these issues. We had five public hearings and 11 drafts and had studied the constitutionality issues and had discussed the public policy issues ad nauseam. Now it is out in the public domain; others need to also have those discussions.

We asked a professor by the name of Joseph Zimmerman at the State University of New York in Albany, who is the world's leading expert on interstate compacts. He's the guy who wrote the book. There's a book, Interstate Compacts and Agreements. He's the author and the well-recognized national expert; so we said to him, just to make sure we didn't miss anything, "Would you review the document, give us a critique, and tell us whether there's anything in here that we missed?" He came back with a report that said, basically, "The constitutional issues it raises are nonexistent.

"However, there are political issues. And you may want to look at having more detail on open meetings, more detail on open records." NCSL looked at this Zimmerman report and said, "You know what? That's a good idea. Let's do that; let's put that in there." We're very confident about these constitutional issues. We

recognize, however, there are public policy issues. Is this the right answer or not? This is our answer, as I said, that we have come to after dismissing all others.

To those people that say the Interstate Compact is not the right answer, my question is, "If not this, then what?" That's the question. I'm open if somebody has got a suggestion; but there is no one yet that has found a suggestion that we haven't already considered.

FROM THE FLOOR: It does appear that some of the state insurance departments, in self-preservation, are sort of counting on their state attorney general saying, "Well, our state can't do this because our constitution won't let it."

MS. VAUGHAN: As I said, I think this is a heavy lift, and it's not going to happen overnight. And there may be a state or two or three where it's not going to happen in three years or in five years. But I think ultimately this is going to be the solution.

I think we're going to get a large number of states next year; we're going to get an even larger number the year after that. And eventually the states are going to come on board.

MR. KEN FAIG: A question for Commissioner Vaughan: Do you anticipate the compact can be an effective tool with only a relatively limited number of state members, such as the insolvency compact currently has? The second element of my question would be: Do you anticipate that members of the compact will amend their uniform policy provisions laws to accord with the compact? I realize that the provision of the compact is that state law is overridden, but you might still think there might be some state courts that would, for instance, if you had a uniform suicide provision that deviated from the state standard, would the state courts uniformly recognize the compact? I am thinking of Missouri, for instance, with their relatively unique restrictions on suicide.

MS. VAUGHAN: You have two questions there. If we only have three or four or five states in the compact, then, no, it's not going to work. First of all, it's not even going to get created, and it's not going to be implemented because we have to have at least 26 states or 40% of the premium volume. That means we either have to get all six of the large states to start, that's 40%, or we have to get 26 states.

As I said, I think that's doable. I think that the regulators have come to the recognition that if we don't do something, someone else will do something. And either we can do it or it can be done to us. The alternatives for having it done to us are not great. They're not very attractive.

In terms of overriding other state laws, the legislation specifically says that the compact has the full force and effect of law, and it replaces any other standards in a state for products that are filed with the compact. We believe that's clearly

enforceable in the courts. Because there is a provision in the compact that if a state wants to retain a different standard, they can opt out of the standards of the compact, then they can take affirmative action to do that. But they would have to do that.

MR. TIM TONGSON: Commissioner Pickens, I understand yesterday you participated in an optional federal charter discussion or debate, I'm not sure exactly what. Anything you can share with our group in terms of how that went?

MR. PICKENS: Sure, the state regulation proponents won; it was not even a contest.

Seriously, we had a representative from USAA, their general counsel, who participated on the federal regulations side; and then a gentleman from AIA. I can tell you that we had maybe 35, 40 people in the audience. I guess I should say on the state side, there was myself and a gentleman named Wayne White, who was a representative of the National Association of Mutual Insurance Companies (NAMIC).

We basically each got a chance to make our presentations with the federal proponents going first, and there were probably, as I said, 35 or 40 people in the audience. Some of those were USAA employees and AIE employees. But there were a number of press people in the audience.

What I found interesting at the end of the presentations, most of the questions were directed at the proponents of the federal charter proposal, and they really were kind of negative questions. For example, there was a gentleman from Bloomberg there. He happened to be a USAA policyholder. He said, "Let me understand what you guys are saying. You're saying that even though you rate my auto policy and my homeowner's policy based on my zip code, you get to that level of detail as far as geography is concerned, and you think a federal regulator is the way to go?" I think they have a hard sell, to be honest with you.

Can you think of anything that the federal government does better than your state government other than collecting taxes and waging war? I can't think of many things that they do better; and when you talk about something as personal as an insurance product, do you want to have to call Washington, D.C. to get your help with the health insurance claim, get your auto claim paid, a homeowner's claim? Frankly, I don't think Congress wants to deal with those.

I'll tell you what we have been hearing on the street about the dual federal charter proposal. It seems that the proponents of the dual federal charter have been running into a little bit of disinterest, I'd say, on Capitol Hill right now. People are saying again that this dual federal charter is a heavy, heavy lift. The governors are opposed to it; most state legislators that we hear from are opposed to it; consumers really don't seem to be that interested in it. Consumers really are the

market. They're not out there clamoring for a federal regulator, and most of them you talk to don't want a federal regulator.

Congress is pretty much telling these guys, "Look, we know what you're saying, but you don't even have it figured out yet. You guys aren't even on the same page. The industry doesn't wholeheartedly support the thing, so you need to come back to us when you have it all figured out." And at this point, they don't. What we are hearing, and this is consistent with the message that they're sending us, is that we're going to continue to put pressure on the states to modernize, to make your laws more uniform, reciprocal.

What we're hearing is that there appears to be more interest and intrigue around the independent insurance agents and brokers for what is called a federal tools proposal. This is where they enact laws relating to rate and form filings, market conduct, producer licensing similar to the NARAB provision of Gramm-Leach-Bliley, which told states, "You have to do this by X date, and if you don't, then you're preempted." That appears to be where the action is right now, and a number of us are coming to town next week, I believe it is, to visit with some folks to see what we can learn about this federal tools proposal, because we obviously have some concerns about it and would like some input if this is going to be where the action is.

It sounds like the federal charter is a little bit on the back burner right now and that people are looking with a little skepticism at this independent agent's proposal; so it will be interesting to see where it goes from here. That's more of a hold-the-gun-to-the-head-of-state-regulators: "You guys pass laws that do certain things by a certain date; if you don't, you're preempted." They think that was fairly effective in Gramm-Leach-Bliley.

MR. DALE HALL: Two quick questions on speed to market with the interstate compact: It seems like from our form filing area, there may be still some states who wouldn't want to see a form filing until it was approved by the state of domicile. I guess I'm assuming that the interstate compact would take care of that. Then the other would be—the option to file with a single state rather than the compact, what's the incentive there? Is the incentive that you should file with the compact because it might take a lot longer if you file with individual states? If you still retain that option, would you eventually push towards the compact or still retain that option perpetually?

MS. VAUGHAN: Well, we left that in the compact. We do not affect other state filing processes because that's the state's decision.

There are a couple of states that have said, "We don't think we'd retain a separate filing process," but that's their decision. I think in Iowa we probably would, because we have some smaller regional companies that operate in Iowa that maybe wouldn't be filing products nationally. So there may be instances where a company

just doesn't want to deal with the compact because they're just dealing with a single state or a couple of states, a regional state. But we've left that to the individual state to decide whether to keep that separate system in place.