

STATE INSURANCE REGULATION

This article provides an overview of state insurance regulation, including a brief history, discussion of state regulatory roles and institutions involved.



A Brief History

Benjamin Franklin helped found the insurance industry in the United States in 1752 with the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire. The current state insurance regulatory framework has its roots in the 19th century with New Hampshire appointing the first insurance commissioner in 1851. In 1869, the Supreme Court held, in the case *Paul v. Virginia*, that "issuing a policy of insurance is not a transaction of commerce." As a result, states were left with responsibility over the taxation and regulation of insurance. The need to discuss issues of common concern led to the formation of the National Insurance Convention in 1871, which later became known as the National Association of Insurance Commissioners (NAIC). Insurance regulators' responsibilities grew in scope and complexity as the industry evolved. Another Supreme Court case (*United States v. Southeastern Underwriters*) led to the overturning of the *Paul v. Virginia* decision. In the *Southeastern Underwriters* case the Supreme Court held that insurance was indeed commerce. This caused turmoil as there was a regulatory void that led Congress to enact the McCarran-Ferguson Act in 1945. The McCarran-Ferguson Act clarified that states should continue to regulate and tax the business of insurance and affirmed that the continued regulation of the insurance industry by the states was in the public's best interest.

The Financial Services Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act, established a comprehensive regulatory framework to permit affiliations among banks, securities firms and insurance companies by repealing the Depression Era Glass-Steagall Act. The Gramm-Leach-Bliley Act once again affirmed that states should regulate the business of insurance by declaring that the McCarran-Ferguson Act remained in effect. However, Congress also called for state reform to allow insurance companies to compete more effectively in the newly integrated financial service marketplace and to respond with innovation and flexibility to evermore demanding consumer needs. It established the concept of functional regulation where each functional regulator is responsible for regulation of its functional area.

The Wall Street Reform and Consumer Protection Act of 2010, better known as the Dodd-Frank Act once again had an impact on state insurance regulation. While primarily banking and securities reform legislation, Dodd-Frank did create the Federal Insurance Office as an information gatherer to inform Congress on insurance matters. It also included some reinsurance reform and changed the basis for regulation and taxation of surplus lines insurers. The Federal Insurance Office was granted limited authority to enter into covered agreements with other nations on insurance regulatory matters. However; the primary state insurance regulatory functions remain as they have been since the enactment of McCarran-Ferguson. This allows to states to perform solvency oversight of the U.S. insurance industry and to regulate insurer behavior in the marketplace.

The Role of the State Legislatures

State legislatures are the public policymakers that establish set broad policy for the regulation of insurance by enacting legislation providing the regulatory framework under which insurance regulators operate. They establish laws which grant regulatory authority to regulators and oversee state insurance departments and approve regulatory budgets. State insurance departments employ 11,600 regulatory personnel (2010 figures). Increases in staff and enhanced automation have allowed regulators to substantially boost the quality and effectiveness of their financial oversight of insurers and expand consumer protection activities.

State regulation of insurance provides a major source of state revenue. In 2010, states collected roughly \$18.6 billion in revenues from insurance sources. Of this amount, \$1.24 billion—roughly 6.7 percent—went to regulate the business of insurance while the remaining revenues went to state general funds for other purposes.

National Association of Insurance Commissioners (NAIC)

The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

The Purpose and Structure of Insurance Regulation

The fundamental reason for government regulation of insurance is to protect American consumers. Insurance is more heavily regulated than other types of business because of the complexity of the insurance contracts, the lack of sufficient information for insurance consumers to adequately shop for prices and adequacy of coverage and because insurance contracts are generally contracts of adhesion. Conceptually insurance regulation is very simple. The public wants two things from insurance regulators. They want solvent insurers who are financially able to make good on the promises they have made and they want insurers to treat policyholders and claimants fairly. All regulatory functions will fall under either solvency regulation or market regulation to meet these two objectives. State insurance regulatory systems are accessible and accountable to the public and sensitive to local social and economic conditions. State regulation has proven that it effectively protects consumers and ensures that promises made by insurers are kept. Insurance regulation is structured around several key functions, including insurer licensing, producer licensing, product regulation, market conduct, financial regulation and consumer services.

Insurer Licensing: State laws require insurers and insurance-related businesses to be licensed before selling their products or services. Currently, there are approximately 7,800 insurers in the United States. All U.S. insurers are subject to regulation in their state of domicile and in the other states where they are licensed to sell insurance. Insurers who fail to comply with regulatory requirements are subject to license suspension or revocation, and states may exact fines for regulatory violations. In 2010, there were 342 companies that had their licenses suspended or revoked. The NAIC's Uniform Certificate of Authority Application (UCAA), an insurer licensing facilitation system, helps states expedite the review process of a new company license. In addition, an NAIC database has been developed to facilitate information sharing on acquisition and merger filings. These databases assist insurance regulators by creating a streamlined and more cost efficient regulatory process.

Producer Licensing: Insurance agents and brokers, also known as producers, must be licensed to sell insurance and must comply with various state laws and regulations governing their activities. Currently, more than two million individuals are licensed to provide insurance services in the United States. State insurance departments oversee producer activities in order to protect insurance consumer interests in insurance transactions.

The states administer continuing education programs to ensure that agents meet high professional standards. Producers who fail to comply with regulatory requirements are subject to fines and license suspension or revocation. In 2010, roughly 5,000 insurance producers had their licenses suspended or revoked. Fines exceeded \$25 million and over \$50 million was returned to rightful owners.

When insurance producers operate in multiple jurisdictions, states must coordinate their efforts to track producers and prevent violations. Special databases are maintained by the NAIC to assist the states in this effort. The National Insurance Producer Registry (NIPR)—a non-profit affiliate of the NAIC—was established to develop and operate a national repository for producer licensing information.

Product Regulation: State regulators protect consumers by ensuring that insurance policy provisions comply with state law, are reasonable and fair, and do not contain major gaps in coverage that might be misunderstood by consumers and leave them unprotected. The nature of the regulatory reviews of rates, rating rules and policy forms varies somewhat among the states depending on their laws and regulations.

For personal property-casualty lines, about half of the states require insurers to file rates and to receive prior approval before rate or policy form filings go into effect. With the exception of workers' compensation and medical malpractice, commercial property-casualty lines in many states are subject to a competitive rating approach. Under such a system, regulators typically retain authority to disapprove rates if they find that competition is not working.

Rates for life insurance and annuity products generally are not subject to regulatory approval, although regulators may seek to ensure that policy benefits are commensurate with the premiums charged. Historically, many states subjected health insurance rates to prior approval—with some states using a

“file and use” system or no provisions for review. The recently adopted Affordable Care Act has changed the landscape for health insurance. All states now must review health insurance rates before they go into effect. Health insurance rates are also subject to review by the Department of Health and Human Services if the rate change is deemed to be “unreasonable.” Improvements are also included addressing the way in which consumers shop for health insurance. Health insurance exchanges are being developed and there is much focus of transparency of consumer information.

State insurance regulators, in the early 1990s, developed SERFF (System for Electronic Rate and Form Filings). The intent was to provide a cost-effective method for handling insurance policy rate and form filings between regulators and insurance companies. The SERFF system is designed to enable companies to send and states to receive, comment on, and approve or reject insurance industry rate and form filings. It has added incredible operational efficiencies that enhanced speed to market for rate and policy form filings. In 2010, over 565,000 filings were processed through SERFF.

Insurance regulators have also been innovative in addressing speed to market concerns of insurers desiring the ability to make a single filing that applies in multiple jurisdictions. The Interstate Insurance product Regulation Compact (Compact) is an important modernization initiative that benefits state insurance regulators, consumers and the insurance industry. The Compact enhances the efficiency and effectiveness of the way insurance products are filed, reviewed and approved allowing consumers to have faster access to competitive insurance products in an ever-changing marketplace. The Compact promotes uniformity through application of national product standards embedded with strong consumer protections.

The Compact established a multi-state public entity, the Interstate Insurance Product Regulation Commission (IIPRC) which serves as an instrumentality of the Member States. The IIPRC serves as a central point of electronic filing for certain insurance products, including life insurance, annuities, disability income and long-term care insurance to develop uniform product standards, affording a high level of protection to purchasers of asset protection insurance products. The IIPRC uses the SERFF filing network for its communications between the 41 participating jurisdictions, representing approximately two-thirds of the premium volume nationwide, and the insurers using the system for filings.

Financial Regulation: Financial regulation provides crucial safeguards for America’s insurance consumers. The states maintain at the NAIC the world’s largest insurance financial database, which provides a 15- year history of annual and quarterly filings on 5,200 insurance companies. Periodic financial examinations occur on a scheduled basis. State financial examiners investigate an insurer’s accounting methods, procedures and financial statement presentation. These exams verify and validate what is presented in the insurer’s annual statement to ascertain whether the insurer is in sound financial standing. When an examination of financial records shows the company to be financially impaired, the state insurance department takes control of the insurer. Aggressively working with financially troubled companies is a critical part of the regulator’s role. In the event the insurer must be liquidated or becomes insolvent, the states maintain a system of financial guaranty funds that cover most of consumers’ losses.

State financial regulators are subject to a peer review through an accreditation process. To achieve accreditation, an insurance department is required to undergo a comprehensive review by an independent review team every five years to ensure the department continues to meet baseline financial solvency oversight standards. The accreditation standards require state insurance departments to have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs, as well as the necessary talent and resources to carry out that authority.

Market Regulation: Market regulation attempts to ensure consumers are charged fair and reasonable insurance prices, have access to beneficial and compliant insurance products and insurers operate in ways that are legal and fair to consumers. With improved cooperation among states and uniform market conduct examinations where uniformity is needed, regulators hope to ensure continued quality consumer protection at the state level. Traditional market conduct examinations occur on a routine basis, but also can be triggered by complaints against an insurer. These exams review producer licensing issues, complaints, types of products sold by insurers and producers, producer sales practices, compliance with filed rating plans, claims handling and other market-related aspects of an insurer's operation. When violations are found, the insurance department makes recommendations to improve the insurer's operations and to bring the company into compliance with state law. In addition, an insurer or insurance producer may be subject to civil penalties or license suspension or revocation.

Insurance regulators, through the NAIC, began the Market Conduct Annual Statement (MCAS) in 2002 with the goal of collecting uniform market conduct related data. The MCAS provides market regulators with information not otherwise available for their market analysis initiatives. It promotes uniform analysis by applying consistent measurements and comparisons between insurers. MCAS has always been a collaboration of regulators, industry and consumers who recognize the benefits of monitoring, benchmarking, analyzing, and regulating the market conduct of insurance companies. Through this teamwork, MCAS has grown from eight states collecting only Life and Annuity information to nearly all states collecting Property and Casualty data, as well as Life and Annuity information.

Consumer Services: The single most significant challenge for state insurance regulators is to be vigilant in the protection of consumers, especially in light of the changes taking place in the financial services marketplace. State insurance regulators have established toll-free hotlines, Internet Web sites and special consumer services units to receive and handle complaints against insurers and insurance producers. The state insurance regulators also have launched an interactive tool to allow consumers to research company complaint and financial data using the NAIC Web site. Called the Consumer Information Source, this web-based tool allows consumers to file a complaint, report suspected fraud and access key financial and market regulatory information about insurers

During 2010, state insurance departments handled over 2.1 million consumer inquiries and over 300,000 formal consumer complaints. As needed, state insurance departments worked together with claimants, policyholders and insurers to resolve disputes. In addition, many states sponsor consumer education

seminars and provide consumer brochures on a variety of insurance topics. Many states publish rate comparison guides to help consumers get the best value when they purchase insurance.