Testimony of the CARFRA Working Group and the Improvements to State-based Systems Working Group of the National Association of Insurance Commissioners

Before the
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Government Sponsored Enterprises
of the
Committee on Financial Services
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Insurance Product Approval: The Need for Modernization

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Testimony of Frank M. Fitzgerald, Chair
NAIC CARFRA Working Group
And
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Introduction

Chairman Baker and members of the Subcommittee, my name is Frank Fitzgerald. I am the Commissioner of the Department of Consumer and Industry Services Office of Financial and Insurance Services. I serve as Chair of the National Association of Insurance Commissioners (NAIC) Financial Services Modernization Task Force and the Coordinated Advertising, Rate, and Form Review Authority Working Group (CARFRA). Joining me today is Lee Covington, Director of Insurance in the State of Ohio. Director Covington serves as Chair of the NAIC Regulatory Re-engineering Task Force, and the Speed to Market—Improvements to State Based Systems Working Group.

Thank you for inviting us to testify regarding the efforts of state insurance regulators, in our own states and through our work as members of the NAIC, to modernize state insurance regulation in the area of product regulation through our Speed to Market Initiatives.

During a Subcommittee hearing on July 20, 2000, Chairman Oxley noted that insurance commissioners, through their "Statement of Intent," "have demonstrated now that they can "talk the talk"; if they can also "walk the walk," then insurance consumers and producers can fully benefit from uniformity without the need for a new federal system." Further, Chairman Oxley "hope[d] that the NAIC working groups [would] not only be able to come up with specific proposals for achieving their goals, but to attach specific time frames to implement those proposals in the 50 States." Product speed to market has been slated by commissioners and industry representatives as one of the highest priorities outlined in the NAIC Statement of Intent. I am excited to report that state insurance regulators remain strongly committed to the product speed to market modernization initiative with unprecedented consensus, and we have accomplished just what this Committee had hoped to see—specific proposals that are now in the implementation process. In just over one (1) year, the NAIC established a vision for modernizing insurance regulation, developed a new and innovative plan for product speed to market, and is now implementing a speed to market plan with extraordinary quickness. We applaud the intense work and commitment of each state insurance commissioner as we have moved forward in our Speed to Market initiatives.

Background

Insurance has been regulated in part because it is a business that is selling a promise to the public that it will be there in time of need. Since the customer receives an intangible product that requires the utmost trust and good faith, state insurance regulators have traditionally been called upon to monitor both the financial performance of insurers and how insurers treat their policyholders. The subject of today's hearing, product regulation and speed to market, relates to an element of market regulation and the treatment of policyholders. State insurance regulators have dedicated staff who read insurance contracts to ensure compliance with applicable state and federal laws because many consumers either choose not to read their policies or cannot understand the legal complexities of the their policies. If the policy language does not comport with state law, a consumer is unlikely to know whether the policy complies with the law at the time a claim is filed and may not receive all the benefits to which the consumer is entitled under the law. States also have staff who are asked to review insurance rating systems to make sure that insurance rates are not excessive, inadequate, or unfairly discriminatory, and to ensure that premiums are reasonable in relationship to the benefits provided.

As the insurance business has evolved, state insurance regulators have acknowledged that traditional methods of insurance regulation need to be modernized to allow the insurance industry to keep pace with its competitors, and to ensure insurance regulators are able adequately serve the best interests of insurance consumers. In the area of product regulation, insurance regulators recognize that historically, it has taken far too long to introduce new insurance products in all 50 states. This is not good for consumers or the insurance industry. Therefore, the NAIC has made its Speed to Market Initiative one of its highest priorities. The Speed to Market Initiative is aimed at improving the timeliness and quality of the reviews given to insurer filings of insurance products and corresponding advertising and rating systems. While the filing and review process is an important element of consumer protection, it is incumbent upon states to react to insurer filings in a timely and expedient fashion. It is also important to provide consumer with access to beneficial products at the earliest possible time.

The NAIC's Speed to Market Working Group was formed in March 2000 to evaluate insurer's contentions that the state-based insurance regulatory system places them at a competitive disadvantage with other financial services sectors because it takes too long for insurers to bring new products to market. The task facing the Speed to Market Working Group was to decide how multi-state regulatory processes and procedures might be integrated with individual state regulatory requirements to provide a timely and responsive regulatory environment for insurers and insurance consumers. In order to keep insurers competitive with other financial service entities and allow consumers to purchase beneficial insurance products, this working group was challenged to find an acceptable combination of timely and quality reviews with appropriate consumer protections.

The working group quickly came to realize that not all insurers were unhappy with state-based regulation and that the motivation for change from different parts of the insurance industry often depended upon whether they faced direct competition from financial institutions and securities firms, or not. Further, consumer interests were very wary of any change that might be perceived to lessen consumer protections.

NAIC Speed to Market Initiatives—CARFRA and Improvements to State Based Systems

To meet the challenges that they faced, the Speed to Market Working Group developed two distinct proposals. In recognition of the distinct efforts that would be required to implement the two separate solutions, the NAIC, in March 2001, divided the Speed to Market Working Group into two separate working groups. The CARFRA Working Group is now charged with oversight of the CARFRA project that will be described later. The Improvements to State-Based Systems Working Group was asked to oversee implementation of the operational and regulatory framework efficiencies that were identified in the Speed to Market Implementation Plan (Dec. 2000—See Appendix). The Improvements to State-Based Systems and CARFRA proposals create timelines and meet the NAIC efficiency goals. These proposals include a phase-in implementation product review timeline of 45-days for industry and regulators alike, with a reduction to 30-days over time.

Before the Improvements to State-Based System initiative and the work on CARFRA are discussed in detail, it is important to be aware of an NAIC initiative that has been developed to provide an electronic system for submission of rate, policy form, and advertising materials. The System for Electronic Rate and Form Filing (SERFF) provides a viable electronic alternative for insurers to meet their rate, policy form, and advertising material filing requirements with state insurance regulators.

SERFF (System for Electronic Rate and Form Filing)

The SERFF system is a robust Internet-Based electronic system that is being implemented in all states as the electronic framework for the NAIC's speed to market initiatives. The evolution of SERFF into the system it is today will enable the NAIC and states to implement their Speed to Market Initiatives. Currently, more than 200 insurers participate on the system, and this number is sure to grow with the NAIC's plan to fully implement SERFF in all 51 jurisdictions. In February of this year, the NAIC membership recognized SERFF as a vital tool that must be in place in all states, and therefore, appropriated $1 Million to fund completion of the implementation plan on an expedited schedule. Currently, 46 states are participating in SERFF and while not all of these states are actively receiving filings, the NAIC's plan calls for active filing status in at least 41 states by the end of 2001, with the remaining states being added in 2002. The NAIC is currently ahead of the implementation schedule and remains extremely optimistic about meeting the deadlines or finishing the project ahead of schedule.

The SERFF system offers a number of advantages for regulators and insurance companies seeking to get products to market in a timely manner, including:

1. The SERFF system serves as the conduit for multiple states to participate in the CARFRA single point of filing system by enabling multi-state product review panels to review a filing through state of the art electronic communications;

2. For products not reviewed through the CARFRA system, including most property and casualty products at this point, the SERFF system allows an insurer to file the product in all states with the touch of a button, as well as:
    - Serving as a gateway to ensure the filing is complete;
    - Allowing an insurer to track the filing during the review process;
    - Providing electronic communications capabilities for state and insurers while the filing is under review;
    - Providing electronic efficiencies during the regulatory review process, such as the ability for more than one person to review the filing;
    - Monitoring the performance of states' adherence to established timeframes and insurers' compliance with the legal requirements for products.

SERFF offers insurers a way to effectively communicate with insurance regulators in an environment that enhances the speed, accuracy and consistency of filing reviews. SERFF will allow all states to implement the best practices identified by the NAIC and industry representatives, and serves as the infrastructure necessary to accomplish the Speed to Market Initiatives. The SERFF system will be mentioned throughout the discussion of CARFRA and the improvements to state-based systems initiative.

CARFRA

This proposal is intended to address concerns about direct competition with other financial services sector companies. The Speed to Market Working Group recommended the development of a system featuring a single point of filing and review, national standards for insurance products, and an efficient state-based procedure for processing the filing. The CARFRA Working Group has assumed the development of this single point of filing process.

The Coordinated Advertising, Rate and Form Review Authority (CARFRA) process began in May 2001 with a limited launch that initially focuses on life and health products. It is the life insurers that are most directly affected by competition from other sectors providing investment type products. The working group believes that CARFRA can also benefit certain property and casualty products and will expand the process accordingly in the future.

The limited launch of CARFRA meets consumers' needs by speeding new products to market while maintaining appropriate regulatory standards of review. CARFRA gives insurers a single point of entry to submit products for review, with the certainty that a filing can be approved for multiple state use within an established number of days.

CARFRA will not require states to slow down or regress in their current processes. For instance, if a participating state is a file and use state, a CARFRA filing can be used immediately in that state upon filing. CARFRA can accommodate a variety of regulatory approaches, not just prior approval.

The limited launch of CARFRA began its part of the regulatory re-engineering process on May 1, 2001. Starting with a focus on life and health products, the limited launch allows insurers to make one filing that will be reviewed based on a set of national standards, together with certifications to state deviations, and receive action from each participating state within 45 days of filing. Future plans call for a 30-day turnaround time.

The basic plan of operation for a CARFRA limited launch was developed by the CARFRA subgroup of the Speed to Market Working Group. The CARFRA Subgroup consisted of six states: Maine, Michigan, New York, Oregon, Pennsylvania, and Texas. The states of Alabama, Arkansas, Indiana and Ohio were added prior to the limited launch on May 1, 2001. The ten (10) states form the core states that will accept and review filings during the early limited launch period. There are other states that serve of CARFRA Working Group so that they can be involved in development of national standards and keep up to date on CARFRA developments.

The purpose of the CARFRA limited launch is:

- To implement, on a limited launch basis, the CARFRA process as a prelude to full implementation of the process;
- To determine the best method for teams to coordinate review and reach consensus agreement on Advisory Recommendations for the participating states;
- To provide information toward accomplishing a long-term goal of identifying best practices that can be legislatively implemented in individual states for greater uniformity;
- To increase the efficiencies, expertise and transparency applied to the review process; and
- To allow implementation of CARFRA on a national basis within a year of the completion of the limited launch.

Improvements to State-Based Systems

The Speed to Market--Improvements to State Based Systems Plan approved by the full NAIC in December 2000, calls for states to implement a plan whereby all insurance products not reviewed by CARFRA, including most property and casualty products at this point, will be reviewed within a 30-day period of time, unless a regulator or insurer requests an additional 30-days in exceptional circumstances. Further, the plan calls for the implementation of an informational filing system, or competitive rating system, for all commercial lines rates.

This plan grew out of the Statement of Intent signed by all Commissioners in March 2000, stating as follows:

> [W]e will take steps to improve speed to market for insurance products. . . . For lines that do not lend themselves to uniform standards, we are committed to reviewing market barriers for further efficiencies. We will also develop an e-repository for filings, a system for tracking data, and a state certification process.
>
> In addition, we will take steps to shift the focus of states away from a prior approval system, where appropriate.
>
> We will continue to explore avenues to reduce unnecessary requirements for policies sold to insurance purchasers with insurance knowledge and market power. Where appropriate, we will explore increased reliance on the benefits of open competition.

The Statement of Intent regarding Speed to Market was further refined in the Vision Statement released by the Speed to Market Working Group in September 2000. In the Vision Statement, the Speed to Market Working Group recognized that not all products will be reviewed by CARFRA. Further, NAIC made a decision that CARFRA will be voluntary for insurers so an insurer may elect to make its filings through the traditional state filing methods or through CARFRA. Thus, there will continue to be traditional state-based filings and the NAIC committed to improving the traditional state based system by adopting a plan encompassing the best practices used by states across the country.

To that end, the working group, in its Vision Statement, charged the Improvements to State-Based Systems Working Group to further develop a number of recommendations, including

- Review of regulatory requirements to determine if they are essential to provide necessary consumer protections and eliminate those that fail to meet this test and are no longer necessary;
- Evaluate the need for prior approval requirements and consider implementing systems that rely more on competition than rate regulation to protect consumers;

From the charges presented by the Speed to Market Working Group, the Improvements to State-Based Systems Working Group developed its goal to create a more efficient state-based filing and review process that provides for consumer protection while offering uniform and consistent speed to market for insurers and consumers. It also developed four objectives to meet that goal:

- Identify operational efficiencies and best practices that states can implement to improve the timeliness, quality and consistency of rate filing review.
- Identify operational efficiencies and best practices that states can implement to improve the timeliness, quality and consistency of form filing review.
- Identify alternatives to current regulatory processes that will offer speed to market for insurers; and
- Identify essential consumer safeguards relative to the rate, rating manual and form review process, identify and promote the adoption of absent consumer safeguards and promote beneficially competitive markets.

After over 10 meetings in just two (2) months, the Improvements to State-Based Systems Working Group developed a detailed set of recommendations for operational efficiencies and regulatory framework efficiencies that was approved by the full NAIC in December 2000. These efficiencies or best practices, along with the CARFRA Initiative, are contained in the NAIC Speed to Market Implementation Plan.

In sum, the Plan calls for a 30-day review period for introduction of a product on a nationwide basis and an informational/competitive rating system for most commercial lines rates. This plan is accomplished through the two-part plan--Operational Efficiencies (i.e. Best Practices) for all insurance products and Regulatory Framework Efficiencies for Commercial Lines Products. With respect to Operation efficiencies, the Plan details a four-step process for creating a 30 day nationwide review system:

1. **Review Standards Checklists and Transmittal Forms:** A best practice identified by the NAIC is the development of clear guidelines based on state law for products sold in each state. The State of Colorado estimates that prior to the development of review standards checklists, less than 20% of filed products complied with Colorado law and where able to be introduced within 30 days. After the institution of checklists, over 90% of their product filings complied with Colorado law and were able to be introduced within 30 days of filing.

   According to the most recent report, in just five (5) months since release of the Plan, over 28 states, representing 50% of the United States insurance market, report that 100% completion of the checklists will be achieved by the end of June, and we continue to receive reports that additional states expect completion by that time. These checklists are scheduled for release on the NAIC website by June 30th. We are well on our way to our goal to have all states completed in 2001;

The checklist and the review standards have a number of intended purposes:

- Provide clear expectations for insurers as to the requirements for product filings.
- Enhance speed and uniformity of review by individual insurance departments.
- Provide a starting point for a process aimed at eliminating inconsistencies between state filing requirements where appropriate and eliminating regulations and policies not necessary to achieve regulatory purposes.
- Assist CARFRA in identifying products with common filing requirements for purposes of determining products that can be reviewed by CARFRA.

2. **SERFF Implementation:** As stated above, in February of this year, the NAIC membership recognized SERFF as a vital tool that must be in place in all states, and therefore, appropriated $1 Million to fund completion of the implementation plan on an expedited schedule. Currently, 46 states are participating in SERFF and while not all of these states are actively receiving filings, the NAIC's plan calls for active filing status in at least 41 states by the end of 2001, with the remaining states being added in 2002. The NAIC is currently ahead of the implementation schedule and remains extremely optimistic about meeting the deadlines or finishing the project ahead of schedule.

3. **Uniformity and Consistency among State Filing Requirements:** The Plan calls on States, to the greatest extent possible, to create consistency and uniformity among state filing requirements by:

   - Eliminating all department policies/desk drawer rules not based on a state law or regulation.

- Eliminating regulatory requirements that do not achieve the regulatory purposes set forth in state law.
- Maintaining and adding uniform regulations that are necessary to achieve the regulatory purposes set forth in the proposed Property and Casualty Model.
- Making remaining regulations as uniform as possible. The Speed to Market Working group should be charged with developing a self-assessment guide to standardizing regulations or taking other appropriate action aimed at standardizing the regulations existing in each state to the extent possible by December 2001.

Implementation of this phase of the project will begin after completion of the Review Standards Checklists.

4. **Review and Compliance Timeframe—30-Days:** The Plan calls for implementation of an operational standard requiring the entire filing and approval process to be completed within 30-days, with an a one time thirty-day extension at the insurer or state's request in exceptional circumstances. The SERFF system will be used to monitor compliance with the operational standard.

With respect to the Regulatory Framework Efficiencies for Commercial Lines products, the Plan provides for implementation of a no filing system for selected commercial lines rates and an informational/competitive rating system for most commercial lines rates. With regard to commercial lines forms, the Plan provides for a file and use system. Currently, four (4) states have a system similar to the system outlined in the plan, and 15 states have been granted the discretionary authority through legislation to move to this type of system. The Plan calls on those 15 states to move to this system at the earliest possible time. For the remaining states, legislation will be required, and at this point, because most legislatures have adjourned for the year, legislative action will be required in 2002.

In regard to the Regulatory Framework Efficiencies for Personal Lines Insurance under the Speed to Market Plan, during 2001, the Improvement to State Based System Working Group will be "study[ing] all issues relating to personal lines rate and form regulatory system, including but not limited to whether a file and use system or flex rating system should replace prior approval systems" and consideration of "deregulation and competitive rating for personal lines rates . . . ." The Working group held its first meeting on this issue in May, where the Working Group heard from more than 18 panelists during a day and half period, representing insurance departments, insurers, consumer groups, and academic institutions. The NAIC expects to hold several other meetings this year on this issue in its efforts, in appropriate circumstances, to move away from prior approval requirements and toward implementing systems that rely more on competition.

Long Term Goals for CARFRA and State-Based Improvements

The CARFRA Working Group has the following short-term and long-term goals:

- Continue to run the CARFRA limited launch for one year;
- Select the next group of products for which it will develop national standards by July 1, 2001;
- Add several more states to the CARFRA limited launch during the second half of 2001;
- Form an evaluation committee consisting of four insurance regulators, three insurer representatives and a consumer advocate by July 1, 2001 so that an effective evaluation of the limited launch can begin; and
- If the limited launch is successful, role out CARFRA on a nationwide basis within one year of its inception.

The Improvements to State-Based Systems Working Group has the following short-term goals:

- Implement the common filing transmittal forms in all states by the September 2001;
- Publish the state review standards checklists for all states and all lines of insurance by September 2001;
- Encourage states that have the ability to modify regulatory requirements toward more market-based regulation to do so as soon as practical;
- Encourage states that require legislation to change the regulatory framework for commercial lines coverage to prepare the needed legislation for the next available session;
- Complete its deliberations on the appropriate regulatory framework for personal lines coverages by the end of 2001;
- Provide its recommendations for amendments to the NAIC's Property and Casualty Insurance Rate and Policy Form Model Law by September, 2001 and present the recommended language to the NAIC's Property and Casualty Insurance Committee at the NAIC's Fall National Meeting

Need for Uniformity Among Insurance Products

One of the principle reasons that the regulation of insurance has traditionally been left for the states is because there are many differences that are not, and never will be, best served by uniform national insurance products. A property insurance policyholder in Florida is worried about damage from hurricanes and houses falling into sinkholes in addition to fire and theft. Those in the state of Michigan are still waiting for their first hurricane, but we face some nasty winter storms and are worried when tornado warnings are given. For those who live in California, we would add earthquakes and tsunamis to their list of concerns. The workers' compensation laws in each state are different. If Congress chooses to move toward uniformity, it would also be attacking the basic legal framework and all of the related case law in the states. In Michigan, the auto reparation system provides unlimited medical benefits in a no-fault environment while her neighboring state of Ohio relies completely on the tort system to compensate its auto accident victims. Therefore, it is questionable as to whether many property and casualty insurance products are not good candidates for uniformity unless a lot of other changes are also made.

The states have recognized that some insurance products are good candidates for uniformity and have taken steps to address those. The CARFRA project provides the state-based solution for insurance products where national uniformity is possible or desirable. It has an interesting side benefit of pointing out in a very clear fashion where state differences occur. It is a good vehicle for a state legislature to see where their state is out of step with the rest of the nation. Once national standards have been developed and agreed upon, states enter the deviations from the national standards into the system so any variance is obvious to public policymakers. This two-pronged approach will allow everyone to opt for the system that they believe benefits their organization best, while recognizing that some insurance products may be impossible or impractical to make uniform.

Successful Speed to Market Effort on Behalf of Banks Selling Insurance Products

At the NAIC's recent Summer National Meeting its Functional Regulation Working Group addressed an issue that had been raised by banking interests. The four federal banking regulatory agencies were required to promulgate consumer protection regulations regarding the sale of insurance products in a depository institution. These requirements were spelled out in Section 305 of the Gramm-Leach-Bliley Act (GLBA). Some banking interests approached Illinois Director Nathaniel Shapo, chair of the Functional Regulation Working Group, and asked if he would consider developing an expedited approval process for insurer applications that are changed only to add the Section 305 disclosure language. They observed that the most efficient way to get these required disclosures before consumers was to include them in insurance application forms. Director Shapo agreed to pursue the request. He presented a proposal that contains a model bulletin and an expedited transmittal form to the working group. The working group promptly acted upon the request. Each state is designating a point person to receive and be sure that these amended application forms receive expedited treatment. This is strong evidence that the functional regulation envisioned in the GLBA is working well. This example of state regulators working with their federal counterparts to solve a speed to market problem bodes well for the future of these valuable relationships.

Conclusion

In summary, the speed to market effort, through its dual track, has developed two separate recommendations that, taken together, will greatly improve the timeliness and quality of product filing and review processes. The limited launch of CARFRA will allow a single point of filing with coordinated regulatory review based upon an agreed upon set of national product standards for certain products. The recommendations for improvements to state-based systems will streamline the way in which individual states handle product filings for the benefit of both insurers and consumers. States are committed to making both of these processes work well to benefit insurance consumers and insurers.