Testimony of
Steve Bartlett, CEO
The Financial Services Roundtable
before
House Subcommittee on Capital Markets, Insurance and GSEs

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INTRODUCTION

Mr. Chairman and members of the Subcommittee, The Financial Services Roundtable greatly appreciates the opportunity to testify this morning regarding modernization of insurance regulation. We commend the Subcommittee for addressing a significant problem facing our financial system and the economy.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine accounting directly for $1.7 trillion in owned assets, $12.4 trillion in managed assets, and $561 billion in revenue, and 1.8 million jobs.

The Roundtable believes that Congress should act expeditiously to assure that the American economy is well served by an insurance industry that is modern, competitive, healthy and responsive to the needs of American consumers.[*] Unfortunately, our current system of insurance regulation and supervision does not and cannot permit the insurance industry to be fully responsive to the needs of the economy or the consumers of its services. Consumers (be they individuals, small businesses, or Fortune 500 companies), and the insurance companies that serve them, need and deserve regulatory modernization now. A significant part of this reform must be an optional federal charter for insurers.

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[*] Attached is the Statement of Policy adopted by the Board of Directors of the Roundtable formally reiterating its support for an optional federal charter.

We believe the Roundtable is uniquely positioned to assist the Subcommittee as it examines the concept of a federal charter in the context of the overall modernization of insurance regulation. The Roundtable's membership includes all elements of the financial services industry – an industry that is national and global in scope. Collectively, our members are regulated and supervised by every significant financial regulator – state or federal – in this country, and many abroad. Indeed, we are the only trade association whose membership includes both traditional insurance organizations, which are regulated under the state insurance system, as well as banking organizations, which have had the choice of federal or state charter/supervision for over 135 years.

In inviting the Roundtable to testify, you have asked us for an overview of the economic and marketplace challenges facing the insurance industry in light of the current state system of regulation, and the costs of that regulation to customers.

Our testimony will:

- highlight some of the marketplace challenges confronting the industry;
- identify the consequences of the current system;
- outline the principles that the Roundtable believes should be applied in reforming and modernizing the insurance regulatory system;
- identify four points which we hope will remain central to your coming deliberations on this important subject.

First, as these hearings will reflect, there is no real disagreement about the need for significant reform and modernization. Every witness you will hear from during these hearings will agree that there is a problem with the current system.

Second, and perhaps most important, the optional federal charter and legislation aimed at improving state regulation are complementary rather than mutually exclusive. They can and should be combined in a single integrated piece of comprehensive legislation.

Third, modernization of insurance regulation is about the economy and our customers and should not be a battle over regulatory turf or the interests of the industry.

And *finally,* we can ill afford to await a crisis to prompt comprehensive reform of this system.

MARKETPLACE CHALLENGES

The direct and indirect costs to national companies of dealing with the inconsistent laws and regulatory requirements of 55[1] different regimes are enormous. These costs are borne by customers and reflected in industry profitability. It is profitability, after all, that allows our companies to offer products and services at the lowest possible cost to the consumer.

One Roundtable member company involved primarily in the life business held inter-company discussions to identify estimated savings based on regulation under a federal charter. The assumptions were that the federal charter would allow for – and regulate – business in all states. The critical areas addressed were product regulation, producer licensing, and market conduct.

Duplicate costs identified were primarily materials, licenses and fees, technology costs, and personnel services. The burden of the state regulatory system on this company's cost structure extended to virtually all operating divisions including the corporate division. Based on an analysis of 2002 costs, savings for this Roundtable member company were estimated to total \$21 to \$25 million annually.

These figures, extrapolated across the breadth of the industry, are illustrative of the savings companies could afford consumers if insurance regulation were modernized. But that is just the experience of one company.

A look at the broader industry is also telling.

In 2000, the property/casualty rate of return (ROR) was 5.8 % and the life ROR was 10%. By contrast the ROR for commercial banks was 16.7%,[2] while the ROR for diversified financial services companies[3] was 21.3%. The 2000 ROR for the Fortune 500 overall was 14.6%. Indeed, according to the Insurance Services Office, Inc., during the period from 1984 to 2000, the return on net worth for the Fortune 500[4] exceeded the return on net worth for both large insurers and the property/casualty insurance industry as a whole for sixteen out of eighteen years.

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[1] 50 states, the District of Columbia, and U.S. territories.

[2] Source: Insurance Information Institute Fact Book, 2002

[3] Companies whose major source of revenue comes from providing diversified financial services. These companies are not specifically chartered as insurance companies, banks or savings institutions, or brokerage or securities companies, but they earn revenue from these sources.

[4] Fortune 500 Combined Industrial and Service Businesses median return on equity.

The myth that insurance companies are wildly successful and overcapitalized is precisely that: a myth. Since its peak in 1999, the capital of the U.S. nonlife industry has declined by $58 billion, or 17%. The trade combined ratio (TCR), the ratio of an insurance company's losses and expenses as to its premiums is an instructive way to view profitability. Since 1970, the property/casualty industry as a whole has had a TCR ratio of under 1:1 just five times. In 2000, the TCR was 116. This means that companies are paying out $1.16 for every $1.00[5] they earn in premium.

According to an article published by BestWire on May 23, 2002, the terrorist attacks, ongoing adverse revenue development, and increased asbestos and environmental payouts combined to make the 4th quarter and the full year of 2001 to the worst ever for the property/casualty sector.[6]

Clearly, under the current system insurance companies are not as healthy as others in the financial services sector. In fact, it is reasonable to assume that under the current state-based system, diversified financial services companies will continue to steer away from the insurance as a core business. The true cost of state-based regulation is manifest in the resulting lack of competition and choice for consumers.

But I do not want to leave you with the idea that profitability is all that has suffered. Companies cannot indefinitely pay out much more in costs and losses than they receive in premium while continuing to serve their customers properly. Consumers ultimately bear the cost in reduced choice and convenience.

This brief discussion is only suggestive of the varied market forces putting downward pressure on insurers including a slumping stock market and new risks associated with terrorist activities. We will continue to work with the Subcommittee to assist in its understanding the financial and economic forces at work in the insurance marketplace.

REGULATORY CONSEQUENCES

If the economic pressures on the insurance industry were solely the result of competition in a free marketplace, the public policy issues facing this subcommittee would be vastly different than they are. But the fact is that the existing regulatory structure adds a tremendous cost burden on insurers and at the same time stifles competition. Both the insurance industry and its customers have paid a significant price as a consequence of the

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[5] The Information Insurance Institute.

[6] A.M. Best Report: P/C Industry's 2001 Was Worst Ever. BestWire News Service, May 23, 2002

failure to deal with issues. Congress reaffirmed the primacy of state regulation when it passed the McCarran-Ferguson Act in 1945, but this country, its economy, and the delivery of services, have undergone a dramatic transformation over the past 57 years. We need to modernize our insurance regulatory system to eliminate unnecessary and duplicative regulatory costs and to permit insurance customers – individual consumers and businesses alike – to benefit from the innovation and efficiencies that only a free market can assure.

- Speed to Market: The need to get individual state approvals for products mean not only long delays in bringing products to market – in some jurisdictions, this can take years – but also huge costs associated with the time, complexity and duplication due to the differing requirements and standards of 55 jurisdictions. And there is a hidden cost to the current system; namely, some products never reach the market – a cost to customers that is impossible to quantify and impossible to deny.

The National Association of Insurance Commissioners (NAIC) has invested enormous time and effort in seeking to reform the system of bringing products to market. We applaud its efforts. But in the end, the NAIC can only propose important and useful changes. To be effective throughout the country, each of the 55 state legislatures and jurisdictions has to adopt these recommendations. That has proven to be impossible to achieve over and over again.

- Decreased Competition: Elimination of prior approval of products and rates in favor of a market-based regulatory framework would make product design and product pricing more competitive to the benefit of consumers. Market-based product design and pricing has led to lower costs and a richer product mix for consumers in virtually every other industry, including the various segments of the financial services industry. We see the benefits of competition every day in the innovation and price competition in the banking sector and in the insurance sector where states like Illinois have provided regulatory relief to insurers. We believe that consumers of insurance products will benefit in the same way.

The current state regulatory structure does not allow consumers to take full advantage of the technological innovations that are driving down the costs of other products and services. This will continue so long as national companies are required to comply with 55 regulatory schemes.

There are other models that provide a similar story. What we see in countries where rates and policy forms are less regulated is that when a company comes up with an innovative idea, others race to get similar products to market which ultimately drives down costs for consumers. Of course, those products that don't meet consumer expectations fail regardless of price. The important point is that the marketplace makes the decision.

- Lack of Uniformity: Unlike 57 years ago, the United States is a single national market for all financial services including insurance. As in every other industry, insurance companies that operate on a national basis should be able to choose one-stop regulation that is free of duplication, redundancy, and inconsistent requirements and interpretations. Based on our members' experiences in the banking sector, we believe that the ability to offer uniform products nationwide under uniform regulation will lower costs and benefit consumers. Also, it will eliminate the customer confusion that results when individuals and businesses move, only to find out that their insurance is far less portable.

- The Resources to Deal with Crises and the Lack of Expertise in Washington: Discussion in Congress in the aftermath of 9/11 has only served to dramatize what is painfully evident: strong federal expertise and oversight with respect to insurance is a critical and missing component in the support and maintenance of a healthy and resilient national economy. One can only imagine the chaos that could have ensued if the terrorist activities of 9/11 had eclipsed the ability of insurers to pay. We want to commend this Subcommittee – and you Mr. Chairman – for your leadership in promoting a temporary federal backstop to allow companies to get back into the business of writing terrorism risks.

PRINCIPLES FOR REFORM

The Roundtable has consciously determined **not** to craft its own proposal to address these concerns. Our decision reflects the fact that our membership has participated in the excellent work of our sister associations. Because we do not have a specific proposal to put forward, the Roundtable is able to work with the Congress and the Administration to pick and choose among the best ideas that are presented. Instead of specific legislative language, The Roundtable Board of Directors has embraced a set of principles that will guide our participation in this debate.

The Roundtable Board of Directors is confident that overwhelming benefits will flow from a modern framework of insurance regulation incorporating a properly conceived and constructed optional federal charter that reflects the following principles:

First, any federal system must be consistent with effective, high-quality state insurance regulation. We know from our bank members' experience that an optional system of federal regulation is completely consistent with a strong and viable system of state regulation. And we know that such a system produces strong players under both charters. For example, J.P. Morgan Chase – a Roundtable member and the 9th largest financial services company in the world – is a state-chartered institution[7]. The state system must remain strong and attractive. We believe, for example, special care must be taken to preserve tax neutrality between state charters and the optional federal charter.

Second, any framework of federal regulation must be truly optional. Insurance providers must have a genuine choice. Experience in the banking arena demonstrates that the competition provided by choice leads not to a "race to the bottom" or "competition in laxity" but a regulatory environment which is at once more effective and more innovative. The benefits that the banking industry and its customers have enjoyed as a consequence of the banking system should be available to insurance firms and their customers.

Third, a federal charter should be designed to permit insurance companies of all sizes and types to engage in multi-state operations in a seamless and effective manner. The marketplace for financial services is no longer restricted by geography – either within this country or beyond its borders. A national charter would recognize that fact and will maximize uniformity, efficiency and innovation. Such a framework will benefit both the industry and consumers.

Fourth, a new federal framework must represent the best in regulation emphasizing modernization and simplification. The federal framework must embody the best practices of state insurance regulation and innovative approaches to regulation from outside the insurance industry. We should not be satisfied with replicating the existing state system of insurance regulation at the federal level – especially pre-approval of rates and forms. Instead, reform should create insurance regulation designed for the 21st century and employ the best current tools and insights. The central tenets of such regulation must be to ensure solvency, protect customers, and allow the free competitive market to determine pricing and products.

Fifth, the system should be comprehensive. A federal option must be appropriate for, and fair to the entire insurance industry. A comprehensive system should grant federal courts jurisdiction over disputes involving nationally chartered companies. Further, the new federal framework should provide a meaningful choice for any insurance organization, regardless of corporate organization and line of business: mutual, reciprocal and stock; retail and wholesale; large and small; or life, property and casualty.

Sixth, the new federal regulator must have the stature and resources appropriate to the task. Establishing the new federal regulator as a new bureau of the Treasury Department would advance this goal, both in terms of prestige and the ability to attract qualified

[7] The Financial Service Fact Book: 2002. Page 28 (firms ranked by revenue).

leadership and staff. The Treasury is a department which has a long tradition of excellence as well as integrity in respecting the autonomy and expertise of its agencies.

If these principles are adhered to, we believe the following benefits will accrue.

- Customers, large and small, individual and corporate, will benefit from competition and choice. Insurers operating under a national charter and a single regulator will be able to serve their customers uniformly and efficiently in all parts of the country. National providers will be better positioned to use electronic commerce.

- An optional federal system of insurance chartering and regulation will bring national standards and practices to insurance regulation, while retaining all the benefits and innovations arising at the state level. Indeed, we believe an optional federal charter is entirely consistent with preserving states' rights and states' regulatory framework. As markets and companies evolve and innovate, a federal agency will be well positioned to develop sophisticated, uniform tools and standards for assessing risk and solvency, as well as appropriate consumer safeguards. As the largest companies become more complex – a virtual certainty under GLBA, a federal regulator will have the resources needed to examine and supervise them effectively.

- A federal framework can bring modernization and simplification to the insurance regulatory system. It should embody the best practices of state insurance regulation and innovative approaches to regulation from outside the insurance industry. A new national charter provides the opportunity to create insurance regulation that is designed for the 21st century and that employs the best current tools and insights.

- Elimination of prior approval of products and rates in favor of a market-based regulatory framework would make product design and product pricing more competitive to the benefit of consumers. Market-based product design and pricing has lead to lower costs and a richer product mix for consumers in virtually every other industry. We believe that consumers of insurance products will benefit in the same way.

- American insurers expanding internationally will benefit from a highly credible home insurance regulator in their home country. A federal agency will naturally be regarded as a peer by regulators in every other country. A federal agency will be a strong and coherent voice in the international arena promoting open markets, competition and transparency in regulation.

- Regulatory costs associated with the current duplicative requirements and time-consuming multi-state reviews would be reduced for companies

> subject to a single regulator. One estimate is that there could be a $300 million savings alone from direct regulatory costs for life insurers from elimination of duplicative exams and licensing fees, and these costs are but a drop in the bucket compared with the costs associated with duplication, delay and inconsistent and conflicting requirements. The elimination of these costs would both enhance soundness and confer significant consumer benefits.

Of course, these benefits will occur only if the new federal framework is well conceived, properly constructed and appropriately staffed.

PROCESS FOR REFORM

We should recognize that there may be spirited debate about specific aspects of the solutions, but there is no debate that the current system requires modernization and reform. The efforts of the NAIC to this end speak for themselves. The question before the Subcommittee is no longer whether but how.

An optional federal charter and framework of insurance regulation is essential to the health and vitality of the American insurance industry. The Roundtable believes that it is equally important that the state system of insurance regulation be strong and vital. We strongly support State efforts, led by the NAIC, to improve the system of state regulation. Our insurance members have actively participated in NAIC working groups to this end. We also support congressional action, where possible and appropriate, to enhance the effectiveness of the NAIC's hard work. And, we are encouraged by the NAIC's efforts to develop state compacts.

Similarly, we are supportive of the thrust of proposals developed by the Independent Insurance Agents and Brokers of America to develop federal legislation that will enhance the workability of the state system. In the last decade, Congress has amended the federal banking laws to ensure the continuing competitive strength and vitality of state banks and state bank regulation, and we are confident that the same can occur with respect to insurance regulation.

At the same time, and this may be the most important thing that I say today: NAIC efforts or others' proposals for uniform national standards are **NOT** alternatives to an optional federal charter. Rather, they are complementary and, properly crafted, perfectly compatible with optional federal charter legislation. The Roundtable urges you to not choose between federal legislation that improves the state system and legislation that provides for an optional federal charter.

For similar reasons, we urge you not to be seduced by the notion that incremental change – starting with legislation to enhance the state system while delaying a federal charter option – is sensible. While we recognize the possible political appeal of an incremental approach, the right thing to do, is to combine optional federal charter legislation with legislation designed to facilitate modernization and reform of the state system into a single comprehensive proposal.

You will undoubtedly hear a great deal from others about the problems that the current system poses for the insurance industry. These concerns are genuine and valid. At the same time, the focus should be on the degree to which the American consumer suffers as a consequence of the current system. The debate must focus on the design of a regulatory system that is appropriate for a national marketplace and that reflects the best practices in the financial services industry.

CONCLUSION

We believe that it is critical that we put in place a framework of federal oversight of insurance immediately. The need for such a system was evident at least two decades ago. The industry and the American public have paid a huge price because neither industry leaders nor we in Washington were willing to grapple with the admittedly difficult substantive and political issues such a step poses. These hearings and your further deliberations lay a firm foundation for action early in the next Congress, if not before.

The Roundtable thanks you for holding this timely hearing and for your commitment to a competitive marketplace. We look forward to working with the Subcommittee in the coming months. I would be pleased to answer questions.

THE FINANCIAL SERVICES ROUNDTABLE

Statement of Policy

Optional Federal Charter

The Financial Services Roundtable is committed to modernization of financial services regulation. In the Gramm-Leach-Bliley Act Congress recognized the market reality that the financial services industry is no longer segmented among the banking, insurance and securities industries. The Roundtable's membership reflects an industry that is national and global in scope and whose diversity embodies these dramatic market and legal changes. As a consequence, the Roundtable includes members historically associated with banking, securities and insurance. Collectively, our members are regulated and supervised by every significant financial regulator -- state or federal -- in this country, and many abroad.

Based on this experience the Roundtable believes that modernization of insurance regulation and supervision is a critical and urgent national priority. The National Association of Insurance Commissioners (NAIC) and the respective states have recognized the need for reform and are engaged in significant efforts to improve state regulation of insurance. The Roundtable applauds and supports those efforts.

At the same time, it has been evident for some time that exclusive state regulation of insurance is simply not appropriate for an industry that is national, and increasingly global. Neither the consumer of insurance services, the industry nor the economy is well served by the current system exclusively. This fact has been widely recognized within the industry and among public officials.

As a consequence, legislative proposals have been developed and legislation introduced which would provide for an optional federal charter and regulatory framework to be created within the Treasury Department. The Roundtable strongly supports these efforts.

In April of 2000, the Board of Directors of the Roundtable formally expressed its support for an optional federal charter. Events since that time and, in particular the Roundtable's experience in connection with terrorism insurance legislation, have served to underscore for the Board the importance of enacting federal insurance legislation promptly. The purpose of this Statement of Policy is to reaffirm the Roundtable's commitment to this goal and to make plain the Roundtable's belief that modernization of insurance regulation must be among the highest priorities of the financial services community.

The Roundtable Board of Directors is confident that overwhelming benefits will flow from a modern framework of insurance regulation incorporating a properly conceived and constructed optional federal charter.

- Customers, large and small, individual and corporate, will benefit from competition and choice. Companies operating under a national charter and a single regulator will be able to serve their customers uniformly and efficiently in all parts of the country. National providers will be better positioned to use electronic commerce.

- An optional federal system of insurance chartering and regulation will bring national standards and practices to insurance regulation, while retaining all the benefits and innovations arising at the state level. Indeed, we believe an optional federal charter is the most effective way to preserve states' rights and states' regulatory framework. As markets and companies evolve and innovate, a federal agency will be well positioned to develop sophisticated, uniform tools and standards for assessing risk and solvency, as well as appropriate consumer safeguards. As the largest companies become more complex, a federal regulator will have the resources needed to examine and supervise them effectively.

- A federal framework can bring modernization and simplification to the insurance regulatory system. It should embody the best practices of state insurance regulation and innovative approaches to regulation from outside the insurance industry. A new national charter provides the opportunity to create insurance regulation that is designed for the 21st century and that employs the best current tools and insights.

- Elimination of prior approval of products and rates in favor of a market-based regulatory framework would make product design and product pricing more competitive to the benefit of consumers. Market-based product design and pricing has lead to lower costs and a richer product mix for consumers in virtually every other industry. We believe that consumers of insurance products will benefit in the same way.

- American insurers expanding internationally will benefit from a highly credible home country consolidated insurance regulator. A federal agency will naturally be regarded as a peer by regulators in every other country. A federal agency will be a strong and coherent voice in the international arena promoting open markets, competition and transparency in regulation.

- Regulatory costs associated with the current duplicative requirements and time-consuming multi-state reviews would be reduced for companies subject to a single regulator. One estimate is that there could be $300 million savings from direct regulatory costs for life insurers alone from elimination of duplicative exams and licensing fees.

These benefits will only occur if the new federal framework is well conceived, properly constructed and appropriately staffed. Accordingly, the Roundtable will be guided by the following core principles as it carries out its commitment to enactment of such a new framework:

First any federal system must be consistent with effective, high-quality state insurance regulation. For example, special care must be taken to preserve tax neutrality and general charter neutrality between state charters and the optional federal charter.

Second, any framework of federal regulation must be truly optional. Insurance providers must have a genuine choice. The benefits that the banking industry and its customers have enjoyed as a consequence of the dual banking system should be available to insurance firms and their customers.

Third, a federal charter should be designed to permit insurance companies of all sizes and types to engage in multi-state operations in a seamless and effective manner. The marketplace for financial services is no longer restricted by geography – either within this country or beyond its borders. A national charter should recognize that fact and maximize uniformity, efficiency and innovation. Such a framework will benefit both the industry and consumers.

Fourth, a new federal framework must represent the best in regulation emphasizing modernization and simplification. The federal framework must embody the best practices of state insurance regulation and innovative approaches to regulation from outside the insurance industry. We should not be satisfied with replicating the existing state system of insurance regulation at the federal level. Instead, reform should create insurance regulation designed for the 21st century and employ the best current tools and insights. The central tenets of such regulation must be to ensure solvency, protect customers and allow the free competitive market to determine pricing and products.

Fifth, the system should be comprehensive. A federal option must be appropriate for, and fair to the entire insurance industry. A comprehensive system should grant federal courts jurisdiction over disputes involving nationally chartered companies. Further, the new federal framework should provide a meaningful choice for any insurance organization, regardless of line of business: retail and wholesale, large and small, domestic and foreign, or life and property and casualty.

Sixth, the new federal regulator must have the stature and resources appropriate to the task. Establishing the new federal regulator as a new bureau of the Treasury Department would advance this goal, both in terms of prestige and the ability to attract qualified leadership and staff.